

THE TENNESSEE VALLEY AUTHORITY AND FINANCIAL DISCLOSURE

HEARING BEFORE THE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

ON

THE TENNESSEE VALLEY AUTHORITY AND THE FINANCIAL DISCLOSURES THE AUTHORITY MAKES FOR THE BENEFIT OF BONDHOLDERS AND POTENTIAL INVESTORS

SEPTEMBER 17, 2002

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TUESDAY, SEPTEMBER 17, 2002

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:37 a.m. in room SD-538 of the Dirksen Senate Office Building, Senator Paul S. Sarbanes (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN PAUL S. SARBANES

Chairman SARBANES. The hearing will come to order.

This morning, the Committee meets to hold a hearing with respect to the Tennessee Valley Authority and the financial disclosures the Authority makes for the benefit of bondholders and potential investors.

During the Committee's markup of the accounting and investor protection legislation, Senator Bunning offered a proposal to make the TVA subject to the Securities Act and the Exchange Act.

At the time, and since we were really focusing in a different direction, I indicated to Senator Bunning that I would be happy to hold a hearing on this issue. Therefore, we did not address it in the course of that markup. Other Members of the Committee have also expressed an interest in this issue, including Senator Miller, and others.

The TVA, of course, is a Federal corporation created by Congress in 1933, pursuant to the Tennessee Valley Authority Act. Today, TVA is the Nation's largest public power company and has operating revenues of over \$7 billion. Its power service area covers 80,000 square miles in the southeastern United States, including almost all of Tennessee and parts of Kentucky, Georgia, Alabama, Mississippi, North Carolina, and Virginia. I hope I have them all.

Ms. HARRIS. Yes, you do.

Chairman SARBANES. Unlike public corporations, the TVA is owned entirely by the U.S. Government. In other words, it has no public shareholders. It is governed by a three-member Board of Directors, each of whom is appointed by the President and confirmed by the Senate. TVA funds itself by selling electricity to customers, as well as by selling bonds and raising capital through other non-equity financing. It has approximately \$25 billion of debt outstanding and securities are held by over 200,000 individuals and institutions.

The TVA published annual and quarterly reports, information statements, offering circulars, of course, press releases, and other

data for the benefit of investors. Its financial statements are certified by a major accounting firm and it is, of course, subject to the oversight of the Congress, the Comptroller General, and an internal Inspector General.

TVA is not required, however, by Federal law to make specific disclosures for investors or file prospectuses or periodic reports with the Securities and Exchange Commission pursuant to the Securities Act of 1933 or the Securities Exchange Act of 1934.

The Committee looks forward this morning to hearing testimony about the extent of the disclosures that TVA provides for the benefit of investors, to look at the question of whether TVA should provide additional disclosures, and the further question of the pros and cons of requiring by Federal law that the TVA should provide specific disclosures, such as those that would be required if they were subject to the Securities Act of 1933 and the Securities Act of 1934.

We have a number of, we think, distinguished witnesses with us this morning. It is our intention to proceed with two panels.

The first panel will be Ms. Skila Harris, a Member of the TVA Board of Directors. She was confirmed by the Senate in November of 1999, for a term that extends to May of 2008. Previously, Ms. Harris worked at private engineering and management consulting firms, held positions with the U.S. Synthetic Fuels Corporation and the U.S. Department of Energy. She serves on the boards of the Knoxville Area Chamber Partnership and the East Tennessee Foundation.

I will defer introducing the second panel until they come to the table, but our other witness on this panel is Alan Beller, Director of the Division of Corporate Finance of the SEC. Mr. Beller has increased the frequency of the Division's review of disclosure filings, implemented regulatory initiatives that improve the filings of public companies. Of course, the SEC is very much in the spotlight nowadays, including, amongst the other Divisions, the one that Mr. Beller directs. Mr. Beller is an expert on corporate and securities law and previously was a partner of the law firm of Clary, Gottlieb, Steen, and Hamilton.

We had invited the Office of Management and Budget to testify. But they apparently found themselves unable to send a witness, so we will not hear directly from the OMB this morning.

Before I turn to the witnesses, I will yield to my colleagues.

Senator Bunning.

STATEMENT OF SENATOR JIM BUNNING

Senator BUNNING. Thank you, Mr. Chairman. I would like to thank you for holding this very important hearing.

I hope Members remember that back during the markup of the Sarbanes-Oxley Accounting Standards bill, I had an amendment to place the Tennessee Valley Authority under the jurisdiction of the SEC. The Chairman was kind enough to agree to hold a hearing on this matter and I appreciate his doing so so quickly. He and his staff—and there are a bunch of them, so, I want to thank them for their hard work for setting this up—have done their usual professional job. I also appreciate the witnesses coming today very much.

Although it is called the Tennessee Valley Authority, it means a lot more to many of my constituents in Kentucky. I know some here may be wondering what in the world does the Banking Committee have to do with the TVA? The fact of the matter is that the TVA has no regulatory body oversight of any kind by anyone, except the Congress of the United States. So it is up to us to keep an eye on what is going on with the TVA.

In the context of the Banking Committee, TVA has a tremendous amount of publicly-traded debt, about \$20 billion worth. And it has a Aaa rating. But this rating is largely due to the fact that TVA is owned by the Federal Government and can unilaterally raise its electricity rates. There are investors all over the country that have bought TVA bonds because it is owned by the Government. But nobody really oversees TVA.

In light of all the recent problems we have seen in financing of private-sector companies, it only seems fitting that Congress makes sure that someone is watching out for the TVA investors. Right now, they do not have all of the same consumer protections that most other bondholders enjoy. We do not need an Enron in the middle of the Tennessee Valley.

To help protect against any problems at TVA, I proposed extending the SEC's oversight to TVA. If it is good enough for the private sector, I think we need to closely look at imposing the same accountability to quasi-government groups like TVA.

I would like to see more disclosure. I would like to see more accountability. For all we know, everything might be going just fine at TVA, but we do not know right now.

Mr. Chairman, to be fair, I do not think we should ask TVA to do anything more than private-sector companies do. But I do not think we should ask them to do less, either. Too many investors have too much money invested here for us not to be sure and not to exercise fair and thorough oversight.

At the very least, I would like to see the TVA follow Fannie Mae and Freddie Mac's lead and voluntarily register with the SEC. I cannot understand why that would be an unnecessary burden. For instance, if they trade securities on the New York Stock Exchange, which they do, they should have to follow the same rules as others who trade on the Exchange.

Mr. Chairman, I am not here to bash TVA. Everybody knows what they have done for the southeastern United States and appreciate the long legacy of their service to our part of the country. But given some of the problems that they have had in running up debt, and given the disputes that they have had with OMB over some of their financing, I am concerned that we have not been keeping a close enough watch on TVA. I think it is time to change that, and today's hearing is a good start.

Thank you again, Mr. Chairman, for holding this hearing. I am looking forward to hearing from our witnesses.

Chairman SARBANES. Good. Thank you, Senator Bunning.
Senator Enzi.

STATEMENT OF SENATOR MICHAEL B. ENZI

Senator ENZI. Thank you, Mr. Chairman. And I thank you for your willingness to hold this hearing today.

I would like to thank the witnesses for agreeing to testify and to Senator Bunning, who has raised this important issue several times and recognized the need for this Committee to evaluate the status of the Tennessee Valley Authority.

In looking at some of the statistics on the Tennessee Valley Authority, it was kind of a surprise to me to find out that their service area is 20 percent less than the size of the State of Wyoming. However, it serves six times as many people and has an incredible amount of more water, as Senator Bunning knows from having visited my State just recently.

But it provides a tremendous service, and I would like to begin by commenting that I believe this hearing is very timely, with the problems in corporate America. It also coincides with the focus of the Congress, Federal and State regulators, and the Exchanges have placed on the need for greater transparency.

This Committee, for one, has led the way in working to provide assurances to investors that we will work to assure them that they are given the information they need and deserve to make appropriate investor decisions.

Recent passage of the Sarbanes-Oxley Act has transformed the disclosure and independence requirements of corporate America. No longer will corporate insiders have the information to make informed decisions, while average investors are left in the dark. I am proud that Congress acted as expeditiously as possible and the bill is being implemented by the appropriate regulators as we speak. I would also like to commend the TVA for agreeing to adopt many of the requirements imposed by the Act and being adopted by the Commission.

While companies who list securities must be registered with the Securities and Exchange Commission, the TVA is left entirely unregulated by the SEC because they are a Government-owned corporation. I find this very troubling and hard to believe that they exist without direct supervision by a specific Federal regulator. The primary mission of the SEC is to protect investors. Investors in TVA are left without this Government watchdog protecting their investments. The SEC has the background and experience to evaluate the disclosures of companies and should be able to watch these books as well.

I know that, historically, other companies have enjoyed exemptions from registration with the SEC. However, these companies have recognized the need for their investors to have the same information as other companies.

I was very pleased when Fannie Mae and Freddie Mac voluntarily registered with the SEC a few months ago, and they are to be commended for their actions. I believe this initiative may need to be imposed on the TVA. We must work to retain integrity in the debt markets to protect investors and to provide uniformity in disclosure statements so that they can be interpreted accurately.

Again, Mr. Chairman, I thank you for holding this hearing. I appreciate your diligence with this issue and I look forward to hearing from our witnesses.

Chairman SARBANES. Well, thank you very much, Senator Enzi.

We will now turn to our panel. We will hear from both of our distinguished witnesses before we turn to questions.

Ms. Harris, why don't we start with you, please.

**STATEMENT OF SKILA HARRIS
DIRECTOR, TENNESSEE VALLEY AUTHORITY**

Ms. HARRIS. Thank you, Chairman Sarbanes, Senator Bunning.

Chairman SARBANES. If you pull that microphone closer to you and speak directly into it, it will be helpful to us.

Ms. HARRIS. Thank you, Chairman Sarbanes, Senator Bunning, and Senator Enzi. It is a pleasure to be here.

My name is Skila Harris and I am one of the three Directors of the Tennessee Valley Authority. On behalf of my colleagues, Chairman Glenn McCullough and Director Bill Baxter, and the employees of TVA, I thank you for this opportunity to speak with you about TVA's financial disclosure and oversight. I would also like to tell you, as Senator Enzi mentioned, about plans that TVA has to uphold the spirit of the landmark Sarbanes-Oxley Act of 2002.

TVA exists to serve the public good. The standard that we hold ourselves to for leadership is to achieve excellence in business performance and in public service, for the good of the people throughout the Tennessee Valley. TVA improves the quality of life of the citizens of the Tennessee Valley in several different ways—through integrated management of the Tennessee River system, through environmental stewardship, and by supporting sustainable economic development throughout the area.

Through its local power distributors, TVA supplies power to 8.3 million people, as Senator Sarbanes mentioned, over an 80,000-mile square area. TVA accomplishes all of this with no Federal-appropriated funds and finances 100 percent of its programs with power revenues.

As a corporation of the Federal Government, TVA does not issue stock, and therefore, its business goals are not oriented toward earnings. Instead, our decisionmaking is focused on adding value to the customers and to the communities across the Tennessee Valley. And that value is defined in the TVA Act.

Recognizing this difference, the oversight Congress put in place for TVA is different from the oversight provided for publicly-traded companies. But make no mistake—as a Government agency, TVA is subject to oversight.

TVA is managed by a three-person Board, as I mentioned. That Board is nominated by the President and confirmed by this body, the U.S. Senate. It can also be removed by the President.

Like many other Government agencies, TVA has an independent Inspector General. And I have with me today, Mr. Don Hickman, who is TVA's Acting Inspector General. TVA's Inspector General conducts audits of the TVA's financial systems, its business decisions, its operations, and its contracts. The Office of the Inspector General reports to Congress and to the public on a regular basis the results of its audits and its investigations.

TVA's Inspector General performs many of the functions that have been identified in the Sarbanes-Oxley Act as functions of the internal audit committee. But it does so with much more authority and many more professional resources.

For example, the Inspector General's staff that reviews and audits TVA's financing statements includes 19 certified public ac-

countants. The Inspector General can investigate not only financial matters, but also any matter which might relate to criminal or ethical violations at TVA. Also, by Federal statute, the Office of Inspector General is independent of the TVA Board. TVA also has an external independent auditor—PricewaterhouseCoopers. The TVA Office of Inspector General provides oversight of that firm's work and maintains the budget for PWC's annual audit of TVA.

PricewaterhouseCoopers audits TVA's financial statements in accordance with Government auditing standards and provides an opinion on whether those statements are presented in conformity with generally accepted accounting principles. TVA's financial results are also included in the Federal Government's consolidated financial statements, which are audited by the General Accounting Office.

In addition, Congress, as we see today, functions in an important oversight role for the Tennessee Valley Authority. The General Accounting Office frequently performs audits of TVA, and its activities, and its programs often at the request of Members of Congress. GAO is authorized to audit TVA's financial statements.

TVA also files reports with the President, the Congress, the U.S. Treasury, and included in these annual reports contains financial statements and a complete record and report on TVA's business activities. And TVA submits an annual budget to the President.

Furthermore, before TVA can issue bonds with maturities of 1 year or more, the Secretary of the Treasury must approve the time of issuance, as well as the maximum interest rate to be charged. And since most of TVA's bonds are traded either on the New York Stock Exchange or bond exchange, and they must meet all of the New York Stock Exchange's through its listing requirements.

By law, all TVA employees must adhere to the standards of ethical conduct for Federal employees. This requires all officers of the Tennessee Valley Authority to complete ethics training and file very detailed financial disclosure statements annually. In addition to these requirements, and consistent with the Sarbanes-Oxley Act, TVA will develop a special code of financial standards of conduct for all officers and business managers, and will provide associated training with those new standards.

Also beginning in 2003, which is only weeks away, TVA's Annual Report will be certified by the TVA's Board of Directors and CFO (the financial statements and the related information for the previous years.) In addition, the Information Statement, which is TVA's primary disclosure report to the public financial markets, will also be certified.

Because TVA is wholly owned by the U.S. Government and does not issue stock, there are no stock options to provide to TVA Directors and Officers. In addition, TVA does not presently provide loans to its officers or Board of Directors and plans to make this its practice in the future.

In terms of auditor independence, beginning next fiscal year, TVA will not enter into any new contracts with its external auditor and TVA will phase out all of its existing consulting and actuarial services currently performed by PWC.

TVA is taking several other steps to ensure auditor independence comparable to those in the Sarbanes-Oxley Act. TVA will require

rotation of the leading audit partners and TVA also will prohibit the hiring of the CFO, Controller, or Chief Accounting Officer, from an independent auditor within a year after working on the TVA contract.

As I mentioned, TVA issues quarterly financial reports and an Annual Report that include audited financial statements. These are similar in content and in timing to the SEC's 10(k) and 10(q) forms. We also provide information statements and offering circulars similar to those prospectuses for publicly-traded corporations. TVA also issues news releases and we have a system for automatic notification by e-mail of any material events that take place relative to our financial conditions. This is similar to, I believe, the SEC form 8(k).

Also, I must say that uniquely among companies that I know, TVA board meetings and all of our decisions are made in a public setting where even the media is present.

To further comply with the Sarbanes-Oxley Act, TVA is forming a Disclosure Committee to document procedures for reporting material events and occurrences on a more timely basis and to improve the information flow to the public and specifically our investors.

TVA meets regularly with its largest investors. We also hold an annual investor and financial analyst meeting where we provide substantial information, and we are there to respond to their questions. I brought with me to submit to the Committee a sampling of the reporting that TVA provides to not only the public, but also to our investors, in addition to the Congress and to the President.

In conclusion, as I have described, TVA has in place a number of mechanisms that ensure that we conduct business in an open and forthright manner. And we are committed to doing even more to ensure that we earn your confidence, your support, and the continuing trust and commitment of our investors, our customers, and the citizens of the Tennessee Valley.

I look forward to addressing your questions later.

Chairman SARBANES. Good. Thank you very much.

Mr. Beller.

**STATEMENT OF ALAN L. BELLER, ESQ.
DIRECTOR, DIVISION OF CORPORATE FINANCE
U.S. SECURITIES AND EXCHANGE COMMISSION**

Mr. BELLER. Thank you, Chairman Sarbanes, Senator Bunning, and Senator Enzi.

I am Alan Beller, the Director of the Division of Corporate Finance at the U.S. Securities and Exchange Commission. I am pleased to have this opportunity to testify before you on behalf of the Commission regarding the application of disclosure and reporting requirements of the Federal securities laws to the Tennessee Valley Authority. From its creation in 1933, incidentally, the same year that the first of the Federal securities laws was enacted, TVA has been wholly owned by the U.S. Government and is considered an agency and instrumentality of the United States.

TVA is currently authorized to issue only debt and to borrow up to \$30 billion. Until 1959, any indebtedness incurred by TVA was

backed by the full faith and credit of the United States. In 1959, Congress eliminated this full faith and credit backing.

TVA has stated that it issues bonds in a variety of structures and sells its bonds to institutional and individual investors on a global basis. Many of TVA's debt securities are listed and traded on the New York Stock Exchange.

Since TVA is an agency and instrumentality of the United States, the offer and sale by TVA of its debt securities are exempt from the registration requirements of the Securities Act, and its securities are within the definition of exempted securities and Government securities under the Exchange Act. In addition, as part of the 1959 legislation, Congress explicitly exempted the issuance and sale of TVA bonds from the requirements or limitations of any other law, including the Federal securities laws. Therefore, TVA does not register the offerings of its debt securities under the Securities Act, and its debt, including debt that is listed on the New York Stock Exchange, is not subject to registration under the Exchange Act. TVA is also not subject to the provisions of the recently-enacted Sarbanes-Oxley Act, although they have indicated this morning, that they intend to comply voluntarily with a number of those provisions.

Congressional action would be required to eliminate the various statutory exemptions. TVA is subject to general antifraud restrictions prohibiting false or misleading statements of material facts.

In 1992, the Commission participated with the Department of the Treasury and the Board of Governors of the Federal Reserve System in a joint report on the Government securities market. As a Government agency, TVA was excluded from the recommendations of that report regarding Government-Sponsored Enterprises, or GSE's. The Commission has not considered the status of TVA since that time.

Our area of interest as an agency involves disclosure to investors in TVA debt and not other aspects of Federal regulation. TVA, while a unique Federally-owned corporation, has many of the same disclosure issues as publicly-held utilities. We believe that investors in TVA's debt securities deserve the same type of information as that provided by other issuers of public debt. We further believe that the Commission's detailed disclosure rules and filing requirements and the staff review and comment process provide the best framework for disclosing information which investors deserve.

Disclosure regarding TVA itself is, of course, more relevant because TVA bonds are not legally backed by the full faith and credit of the United States. Disclosure should give the holders of TVA's debt a materially complete and accurate picture of TVA's financial and operational situation to permit them to evaluate their investments and their investment decisions.

In preparation for this testimony, the staff of the Commission has considered certain recent disclosures by TVA available on its website. This overview does not represent a full review of those documents, has not involved a typical comment process with TVA, and does not attempt to cover all of the comments that the staff might issue in a full review. TVA's disclosures in its most recent information statement and annual report, in its quarterly reports, offering circulars, and other materials generally include most of the

same disclosures as companies that file reports with the Commission, and these disclosures appear on their face to be responsive to our important disclosure areas and concerns. There are certain areas where we believe TVA's disclosures would be enhanced if the Commission's line item disclosure requirements and staff review and comment applied.

Based on the work done, we would identify possible enhancements in the areas of management's discussion and analysis of financial condition and results of operations and in an area of market risk disclosure. Our rules would also require disclosure in the areas of executive compensation and, to the extent they exist, related party transactions.

There are other areas relating to the descriptions of TVA's business and property where we might, depending on the comment process, seek additional disclosure.

Finally, under our rules, TVA would be required to file and make public specified exhibits, including certain material contracts made outside the ordinary course of business.

There is a tension between TVA's status as a Government agency and instrumentality and the resulting statutory exemptions, on the one hand, and the desire for disclosure that meets Commission standards on the other hand. Unlike the GSE's addressed in the 1992 report discussed previously, including the Federal National Mortgage Association, Fannie Mae, and the Federal Home Loan Mortgage Corporation, also known as Freddie Mac, TVA is not a profit-making corporation and does not have private shareholders or publicly-held equity securities. As such, a different statutory regime may be appropriate.

There are a number of ways that a disclosure system could be applied to TVA. One way would be to change the statutory scheme to eliminate the Securities Act and/or the Exchange Act exemptions. Removing either of these exemptions would result in TVA becoming subject to the reporting requirements of the Exchange Act. Its disclosures would then have to comply with the Commission's detailed line item disclosure requirements and would be subject to the staff review and comment process.

Because TVA is a Government agency and instrumentality and does not share many of the characteristics of the GSE's previously mentioned, and because the Commission has not considered TVA since the 1992 report, where it was excluded from our GSE recommendations, we are not advocating a change in TVA's statutorily-exempt status.

In particular, we believe that the Commission's objective—disclosure that meets Commission requirements and standards—can be achieved by alternative means. One possibility would be voluntary compliance or registration under the Exchange Act, a course of action recently taken by Fannie Mae and Freddie Mac and which achieves effectively the same results insofar as disclosure is concerned as eliminating the statutory exemptions.

In conclusion, the individual and institutional investors who hold TVA's debt securities depend for repayment on TVA's net power proceeds and refundings and not a Government guarantee. We believe that applying the Commission's disclosure requirements and processes is the preferred method of ensuring that these investors

receive the disclosure they deserve. TVA's status and exemptions from the registration and reporting requirements of the Federal securities laws are not necessarily an obstacle to that result. As previously indicated, there are a number of courses of action, including voluntary action by TVA, to achieve the desired standard of disclosure.

Thank you very much for the opportunity to testify before you this morning and I would be pleased to answer any questions that Members of the Committee may have.

Chairman SARBANES. Well, thank you very much, Mr. Beller. I have just a couple of questions, then I will yield to my colleagues.

Just so I am clear in my own mind, does the Tennessee Valley Authority Act define the geographical jurisdiction in which the TVA may function?

Ms. HARRIS. Yes, sir. A 1959 amendment to the TVA Act defined what we generally call the fence. It is the area in which we can sell power and the area that is excluded from other suppliers providing power in that region.

Chairman SARBANES. And how is that defined in the statute? By river basin or by actually setting out States and counties?

Ms. HARRIS. It is a geographical description—the river basin does not necessarily mirror our service territory. So there are two different areas—we have the area of the watershed of the Tennessee River, which is actually larger than our service territory.

Chairman SARBANES. Now, second, I understand that you are a not-for-profit organization. Is that correct?

Ms. HARRIS. We are not in the classic definition of 501(c)(3). That is not what renders us a not-for-profit. As a Federal Government corporation, and as specified in our Act, our motivation is not to create a profit. What we do is basically generate revenues to fulfill our business functions, and obviously, includes paying down debt, operations and maintenance. And then, any left over, we simply reinvest back into the corporation.

Chairman SARBANES. So any, what in the private sector would be considered to be profits, you in effect put back into the operations of the TVA.

Ms. HARRIS. Yes.

Chairman SARBANES. Is that correct?

Ms. HARRIS. It is a closed loop.

Chairman SARBANES. Now did I understand you to say that all of your meetings of the three-member Board of Directors are open to the public?

Ms. HARRIS. Any decisionmaking meetings are open to the public. The public attends, the media attends.

Chairman SARBANES. Is that required by statute, or is that a voluntary policy of the TVA?

Ms. HARRIS. Yes, sir, by statute.

Chairman SARBANES. Your own statute or broader, Freedom of Information, Federal statutes?

Ms. HARRIS. You are testing my memory here. But my memory tells me that the TVA Act requires us to conduct our meetings in public. I could be corrected on that, possibly.

Chairman SARBANES. I think some people behind you——

Ms. HARRIS. That is correct. I got it right.

Chairman SARBANES. Mr. Beller, you, of course, hear from investors. I do not know whether you hear from investors in TVA debt securities. But as a matter of information, have you received complaints at the SEC about the information available and the disclosures from investors, or would-be investors, in TVA bonds?

Mr. BELLER. I cannot say that we have a completely scientifically perfect way of knowing that.

We did check in connection with preparing for this testimony with our investor education office, and, going back several years, we do not appear to have had any such complaints relating to TVA disclosure.

Chairman SARBANES. Okay.

Senator Bunning.

Senator BUNNING. Thank you, Mr. Chairman.

The main reason that they wouldn't have any complaints, Mr. Chairman, is the fact that they are Aaa-rated bond and the Federal Government owns the company.

So there wouldn't be—unless you know the intricacies of how TVA works, like the fact that their money is reinvested in the company, and the fact that they have X-amount of debt, generally speaking, the more sophisticated investor looks at the rating of the bond and who owns the company. There wouldn't be any complaints at all because the Federal Government owns the bond.

Chairman SARBANES. Well, that may well be. But I get complaints all the time from people about things that the mayor or the governor are doing—

Senator BUNNING. Me, too.

[Laughter.]

Chairman SARBANES. And I do not need jurisdiction over that. So, I am just trying to inquire because, presumably, if there is a lot of discontent, the SEC might well have heard about it.

If I were an investor and wanted to complain, the first place I would think of going to would be the SEC. I think the SEC likes to think that that is the case.

Senator BUNNING. That is certainly correct. I will get to my questions, then.

Ms. Harris, do you know any other entity other than TVA that does not have a Federal regulator?

Ms. HARRIS. Well, sir, I might disagree with your premise that we do not have any regulator at all. Certainly, the Nuclear Regulatory Commission is very much a part of TVA's—

Senator BUNNING. Only in regards to your nuclear power plants.

Ms. HARRIS. Yes, sir. That is a very important part of our business. The Environmental Protection—

Senator BUNNING. I am talking about the conducting of your business, not just an entity within the TVA. Is there any overall Federal regulator for the Tennessee Valley Authority? Every Government agency that I know has an Inspector General.

Ms. HARRIS. Yes, sir.

Senator BUNNING. So the fact that TVA has an Inspector General is to be expected.

Ms. HARRIS. Yes, sir.

Senator BUNNING. So can you answer my question?

Ms. HARRIS. To say that there is an entity that has the scope and the authority to regulate overall business activities of TVA, I would say, no.

Senator BUNNING. Thank you.

You correctly stated that the Environmental and Public Works Subcommittee on Clean Air, Wetlands, and Climate Change has jurisdiction over TVA, in your written statement.

Ms. HARRIS. Yes, sir.

Senator BUNNING. My guess is that they have as much expertise on financial disclosure as has this Committee on the power generation. Why not disclose with the financial disclosure experts at SEC?

Ms. HARRIS. As we heard today, I think that there are some real opportunities through collaboration with the SEC to develop some—Mr. Beller, I think you used the term, alternative means, for TVA to enhance the information that it does provide.

I was also pleased to hear that you generally find that the information that we are providing now to investors is more or less like what everyone else provides to investors.

I think that investor relations and the confidence that our investors have, and possibly new investors in TVA, their level of confidence in TVA is very important to us. And we certainly, it is in our business interest to improve our disclosure. And I think that we have shown our commitment to do that, sir.

SENATOR BUNNING. Well, if you are going to change your cooperation governance to bring it more in line with Sarbanes-Oxley, why not take the next step and voluntarily register your bonds with the SEC, as other GSE's are doing?

Ms. HARRIS. And this probably exhibits my own misunderstanding here. But my understanding was that the agreement that Fannie Mae and Freddie Mac had entered into really went to the question of their equities, not their debt securities. And I would appreciate it if anybody could expound on that because if it could be clarified, I would appreciate it. But my understanding was that they had only agreed to register their equity securities.

Chairman SARBANES. I think that is correct.

Senator BUNNING. That is accurate, but insignificant, because everything is reflected in the disclosures that they are now voluntarily disclosing as far as their equity is concerned.

Ms. HARRIS. I think that the same is very true for us, but I am looking forward to working with the SEC to get their response to how we can improve and enhance our disclosures to the point that we would be able to elevate the confidence of investors.

It is my understanding that you already have said that the SEC said that you should voluntarily register. That is one of the conclusions, I think that that is one of the alternatives.

Senator BUNNING. That he came to.

Ms. HARRIS. Right. I think it was, and my understanding, I certainly do not want to misstate your testimony, but I thought that the door was open for some discussions of alternative means for TVA to increase and enhance the kinds of disclosures that it now provides to the public and to our investors.

Senator BUNNING. Well, if you want me to read it word for word, I refer you to the conclusion in the SEC's testimony about voluntary disclosure of TVA's securities to the SEC. And it is pretty

clear that that is one of their highly recommended alternatives to changing all of the legalese that we have in the laws now. Given the SEC's testimony, is TVA willing to go and take a look? Do you have any flexibility as far as voluntarily registering with the SEC?

Ms. HARRIS. What I am looking forward to is pursuing the various alternatives that were raised today. And I think that, as we sit down, there are certain aspects of our governance structure—I certainly find the role of oversight, the watchdog role that our Inspector General plays for TVA, to be a very powerful protective mechanism for us.

So there are some other types of structural differences that I think that I would look forward to working with the SEC to find out how we can better disclose and build the confidence, not only of this Committee, but also of investors.

Senator BUNNING. Let me just finish up by asking you two more questions.

Ms. HARRIS. Sure.

Senator BUNNING. Why is it more costly inside the fence for electricity than it is outside the fence?

Ms. HARRIS. It depends on where you are near the fence, sir.

Senator BUNNING. I understand that. But why is it if your mission is to provide the lowest cost electricity possible, why are investor-owned and rural electric co-ops producing electric cost less outside the fence than inside?

Ms. HARRIS. As you well know, I was raised in the region of Kentucky that TVA serves. So, I am very familiar with the situation that you are talking about.

One of the things is that TVA has a different fuel mix than most of the utilities. If we are specifically speaking to Kentucky utilities and how they generate their electricity, they are very fortunate. They have mine-mouth coal plans. That is a very efficient way to generate electricity. We have one located in Paradise, Kentucky. That is a very efficient, low-cost plant.

We think that TVA has value because we do have a fuel mix. We have coal. We have solar. We have geothermal. We have nuclear. We have gas combustion turbines. So, we believe that mix, it does mean that, in part, our costs are higher because of past investments TVA has made. But we believe, and one of our six objectives is to continue to reduce the delivered cost of power. And we are committed to being competitive with those other utilities in the Commonwealth of Kentucky.

Senator BUNNING. Well, Ms. Harris, I am not going to get into a dispute with you on TVA's ability to sell outside the fence because I happen to agree that they should have the ability. But I also agree that it should be a two-way street.

Ms. HARRIS. I agree, sir.

Senator BUNNING. That the people should be able to come within the fence and sell and be competitive with TVA inside the fence.

Ms. HARRIS. We are certainly in agreement on that, sir.

Senator BUNNING. Last, but not least, you mentioned the fact that you are complying now with the separation of function.

Ms. HARRIS. Yes, sir.

Senator BUNNING. Even though you are not covered by the law. In other words, you are exempt from Sarbanes-Oxley.

Ms. HARRIS. Yes.

Senator BUNNING. Do you think if you did not comply with the law, that somebody would be coming down and descending on you rather rapidly if you weren't doing it voluntarily?

In other words, you have decided to separate the two functions, the auditing function and the advising function, as the law states.

Ms. HARRIS. Let me just say, in 1995, our Inspector General identified as an issue the fact that our independent auditor was also doing consulting work with TVA.

So, I must say, this is a perfect example how our Inspector General—at that time, in 1995, when that was identified as a potential issue, long before it was an issue in the minds of anybody else across the United States, that was identified and the decision was made because that was the common practice throughout the private sector.

Senator BUNNING. The private sector.

Ms. HARRIS. Right.

Senator BUNNING. Not the public.

Ms. HARRIS. Absolutely. Private sector, that we would continue to do that.

This has been an issue that TVA has been aware of for quite a while. And so, we believe it is the right thing to do. I do not think that we made this decision because we thought somebody was going to come down and get us. I think we did it because we think it is the right thing to do.

Senator BUNNING. One question for Mr. Beller. Do you believe that voluntary registration of the SEC, such as Fannie Mae and Freddie Mac, would be undue, costly, or burdensome to TVA?

Mr. BELLER. I think, Senator Bunning, that the one-word answer to that question is, no, I expect it probably would not, based on a couple of assumptions that we are not 100 percent sure of.

The principal cost of compliance with our registration and reporting requirements is generally the expense of an external audit in accordance with GAAP and generally accepted auditing standards.

TVA already incurs that cost, I expect in full. I do not believe that there would be much, if anything, additional that they would have to do there. There would probably be some additional advisory expenses. But I do not think, given the amount of disclosure they currently provide, there would be, I expect, some incremental costs. I would be surprised if it were significant in comparison to what they incur now in terms of disclosure and reporting.

Senator BUNNING. Thank you.

I have some additional questions, but go ahead, Mike.

Chairman SARBANES. Senator Enzi.

Senator ENZI. Thank you, Mr. Chairman. I did not know that this was going to be such an opportunity for Wyoming today.

[Laughter.]

The county that I come from in Wyoming is the largest producer of coal in the United States. We produce a third of the Nation's coal there. One of the things our State has been looking at from an economic development standpoint is having some power plants at the mine mouth.

Ms. HARRIS. Yes.

Senator ENZI. We would invite you to take a look at having one of your power plants in Wyoming and you wouldn't have to ship all that coal clear out there.

Ms. HARRIS. I will let you and Senator Bunning resolve that.

[Laughter.]

Senator BUNNING. We will work on that together.

[Laughter.]

Senator ENZI. I am hoping that you just use some good accounting, look at the numbers, and of course, I know what the result will be then.

[Laughter.]

Chairman SARBANES. Well, mine mouthing, you produce the electricity right at the mine mouth, don't you, and then transit it?

Ms. HARRIS. Yes.

Chairman SARBANES. That would be pretty costly. How much of it would be left if you tried to transmit it from Wyoming?

[Laughter.]

Senator ENZI. Plenty. What we do is we put it in at the grid and that moves some electricity over a little ways. This electrical stuff is fascinating.

[Laughter.]

When I was mayor, our municipality owned their own electrical generating and power system.

But getting back to the main issue here, Congress is supposed to provide the oversight over TVA, as well as all of the Government agencies. In looking at it, I have to tell you, we are not very good at oversight over accounting or oversight over disclosure.

I have a lot of confidence that TVA is doing better than the Government agencies because we have had the opportunity to audit some Government agencies. And in the audits that I saw, I think that the Forest Service did the best job. They were \$200 million out of balance.

So, I am not sure that the TVA wants to associate themselves with the oversight and the accounting that we provide. It may well want to take a look at kind of separating it as Fannie Mae and Freddie Mac did by going under some SEC jurisdiction. And of course, the easy way to do that is the voluntary method because, as Mr. Beller explained, we would have to do quite a bit of legislating in order to be able to change the system. I am not sure that changing the system is at all necessary.

I did hear your comments about the Inspector General. But I think the Inspector General, from the perspective of people who are now paying a bit more attention in the financial markets, would be more of a relationship to a chief legal counsel within a corporation, that the ties are a little bit closer there. Whereas, the SEC is looked at as more of absolutely outside oversight with different capabilities than there might be by an Inspector General. And in a moment I will ask you for your reflection on that. But a couple more specific questions before I get to that. Does the TVA follow already all the rules on GAAP consistent with other utilities?

Ms. HARRIS. Yes, sir.

Senator ENZI. I thought that was the case. Now does the TVA have any additional off-balance sheet or off-budget arrangements of which we might not be aware?

Ms. HARRIS. No, sir. The TVA Act limits the business activities that we can engage in. We cannot have subcorporations that are separate. A lot of the things that have raised suspicions over the last few months, TVA, by its own statute, is prohibited from engaging in those activities.

Senator ENZI. And so, you do not have off-balance sheet transactions or off-budget arrangements.

Ms. HARRIS. No.

Senator ENZI. In your testimony, you spoke extensively about the disclosure requirements you currently perform. And of course, in your testimony, which will be part of the record, your complete testimony, it is even more extensive that you go into that.

Ms. HARRIS. Right.

Senator ENZI. So that gets back to this original question—why wouldn't you just adopt the SEC registration requirements, such as Fannie Mae and Freddie Mac, on a voluntary basis?

Ms. HARRIS. What I want to do, and I think that we are going to be able to benefit from this, is to work with the SEC to see exactly how we can improve and in whatever form, whichever one of the alternatives that was listed, which one that we feel most comfortable with and that we feel like that will bring about, instill the most investor confidence. That is what I would like to do as a result of this hearing and I appreciate the fact that this has brought TVA and the SEC together.

I was not around in 1992 when the last report was done, so, I think that this is an opportunity for us to work together to get to whatever is best, given the circumstances of TVA. And I think as we talk, we are going to be able to identify what scenario is best to get to what you are talking about, that full disclosure.

Senator ENZI. What is the downside to doing this voluntary registration?

Ms. HARRIS. I do not think that we fully understand what that all entails. It is hard for me to define right now what the downside is because I do not know exactly what that would fully entail. And until we go through that exercise, I do not think I can say, this is why we would not want to do it because I do not know the full extent of that.

Senator ENZI. Okay. And I would rather talk to you about coal sales, anyway.

[Laughter.]

Thank you, Mr. Chairman.

Chairman SARBANES. I wanted to ask a couple of questions here.

First of all, I want to commend the TVA for moving to put in place various provisions in the recently enacted corporate accountability and accounting responsibility legislation. There was an effort there, of course, to define some best standards, or at least best minimum standards, so to speak. And I think your report on the steps that TVA is taking are important in that regard.

Ms. HARRIS. Thank you.

Chairman SARBANES. Second, this is a very informative hearing, at least for me. I never realized until I came here this morning and we got into this, that there was this problem about electricity rates inside the fence and outside the fence, which seems, I gather, to

be a pressing issue, particularly in the Commonwealth of Kentucky.

Ms. HARRIS. That is right.

Chairman SARBANES. So, I am gaining some additional knowledge, which I heretofore had not had.

Now, Mr. Beller, I want to be sure I understand your position.

As I understand it, if the TVA were to move in various ways to additional disclosures, and you mentioned some areas where you thought attention could be paid—market risk disclosure, executive compensation, material contracts, and so forth—that would meet the disclosure question. The disclosure question is separate from the registration question. It is not necessarily encompassed within it. Isn't that correct?

You could come in here today and say, well, the TVA is disclosing everything we can think of that they ought to disclose. Now that is not your position. You think that there are some additional things that they could do. But that could be done without reaching to the issue of whether they should be required to register with the SEC. Isn't that correct?

Mr. BELLER. Senator Sarbanes, that is a very interesting question. There are two separate issues. Disclosure and registration do not necessarily go hand in hand.

We could not, on the face of TVA's documents, because we would not have had the benefit of a review and comment process, reach definitive conclusions about their disclosure. But we could go through a review, or the equivalent of a review and comment process with them on a voluntary basis.

Chairman SARBANES. I am not sure we should be so quick this morning to simply cross over the threshold of the unique institution which the Tennessee Valley Authority is, and the basis on which these decisions have been made in the past. In other words, in 1992, they did not bring TVA under when they were doing this review.

How many companies do you have that have to register with the SEC where the directors of the company are appointed by the President of the United States and are then confirmed by the U.S. Senate?

Mr. BELLER. I know that when we moved to voluntary registration of Freddie Mac and Fannie Mae, a portion of their boards are appointed by the President. But entire boards, I am not aware of any.

Chairman SARBANES. Of course, they are profit-making organizations, aren't they, and they issue equities?

In fact, I thought we established here that the agreement they have entered into with the SEC involves their equity and not their debt. Is that correct?

Mr. BELLER. It is true that what they are registering is their equity securities. The consequence of registration, as I believe Senator Bunning pointed out, is basically full disclosure that is for the benefit of all, the holders of both their equity and their debt and other fixed-income securities. Whether they were to register equity or whether the TVA were to register debt, would result in the same disclosure requirements with very few exceptions applying.

Chairman SARBANES. You say you are going to get full disclosure from Fannie Mae and Freddie Mac of their debt? Is that right?

Mr. BELLER. That is correct.

Chairman SARBANES. But not by it being registered with the SEC. Is that correct?

Mr. BELLER. No. By virtue of their registering any securities with us, they have to disclose information that is material to all of their security-holders.

Chairman SARBANES. Of course, not all of their directors are appointed by the President. In fact, I think only a minority.

Mr. BELLER. I think it is a third.

Ms. HARRIS. A third, yes.

Chairman SARBANES. Yes.

Mr. BELLER. To my knowledge—

Chairman SARBANES. This is a rather unique institution isn't it, the Tennessee Valley Authority?

Mr. BELLER. It is, indeed. I hope we are cognizant of that. In our testimony, we would not propose the same recommendation that was proposed in 1992 with regards to Fannie and Freddie, which was registration. I think we are looking for an alternative solution. Whether that solution is voluntary disclosure or voluntary registration, is something that I believe we would need more of an interaction to know.

Chairman SARBANES. Well, if the purpose of the registration, whether compulsory or voluntary, would be to get disclosure, and if you get the disclosure without either the compulsory registration or the voluntary registration, then the objective has been accomplished, has it not?

Mr. BELLER. Yes, it has, sir.

Chairman SARBANES. Senator Bunning.

Senator BUNNING. Yes, thank you, Mr. Chairman.

Ms. Harris, I believe you, in answering Senator Enzi's question, misstated some positions as far as TVA is concerned, and I want to bring up a couple of them.

Ms. HARRIS. Sure. Go right ahead.

Senator BUNNING. TVA and OMB, in a highly-publicized disagreement about whether or not TVA's lease-back—lease/lease-back arrangements—

Ms. HARRIS. Right.

Senator BUNNING. —Should be counted toward TVA's debt cap. It is my understanding that TVA has continued to lobby OMB to reverse the decision that it made. Is this an attempt by TVA to continue to do these types of lease transactions, and have these and future lease transactions off budget, rather than to treat these lease transactions properly as part of its debt or part of TVA's Congressionally-mandated debt cap?

Ms. HARRIS. With regard to the lease/lease-backs which we are using for combustion turbine units, we address those lease/lease-backs on our financial statement according to GAAP. How we treat those, we are driven, how we put them on our financial statement, by generally accepted accounting practices.

There is a line that says what our debt is and then below that, it says, other financial obligations. And then, based on GAAP, we list those on our financial statements as other financial obligations.

First of all, I am not sure if I agree with the characterization that we were in some hotly contested battle with OMB.

Senator BUNNING. It seems that you are because you continue to lobby OMB to change their decision that they made.

Ms. HARRIS. I haven't been aware of that. It doesn't fee—

Senator BUNNING. That is why we needed our gentleman from OMB here today that did not show up.

Ms. HARRIS. The requirement that OMB has for categorizing for the purposes of the Federal budget, how it characterizes how we do our financings, what our debt is, is a totally different function than how we report our financial statements.

For us to be inconsistent with GAAP in this particular situation I think would be the basis for us to be criticized to be out of sync with the GAAP only on that particular item.

Basically, where I think TVA and OMB ended up is OMB feels like it needs to list that on the Federal budget, and the way it does—and my understanding is that it is not listed as part of our debt. There is a separate line that says something like, other financial obligations. So, they even separate it from the overall debt. Now, the cumulative total adds to the Federal debt ceiling. And TVA certainly does not have a quarrel with how OMB characterizes for its own purposes the cumulative total toward the Federal debt ceiling. That is not part of our business. That is OMB's responsibility.

Senator BUNNING. Well, there is a disagreement between you and OMB because if there weren't, you would have accepted the fact that they are using those transactions and that that debt is being counted toward the Congressionally-mandated debt cap that you have.

Ms. HARRIS. I certainly do not feel that we have a disagreement with them.

Senator BUNNING. Okay.

Is any maintenance or scheduled repairs or replacements of the facilities being or will be deferred as a result of the obligation it has taken to restart Brown's Ferry?

Ms. HARRIS. Are you asking if other things are being delayed to finance—

Senator BUNNING. Is any maintenance or scheduled repairs or replacements of the facilities being or will be deferred as a result of your trying to restart Brown's Ferry?

Ms. HARRIS. And I assume you are talking about our overall fleet of generation.

Senator BUNNING. Absolutely.

Ms. HARRIS. Okay. All of our units. As a matter of fact, we are spending just about the same for maintenance and repairs—

Senator BUNNING. You are not deferring anything because you are trying to restart Brown's Ferry?

Ms. HARRIS. Let me say, in the upcoming budget, 2003 budget, the largest expenditure that we have is \$528 million that we are spending on pollution control equipment. If anything, that so overshadows what we are spending on Brown's Ferry 1 restart, that we are on a track so that we can burn more good Kentucky coal in compliance with environmental standards. What we are doing is balancing our business. Next year's expenditure, the bulk of it is

going to be for environmental pollution control equipment. Brown's Ferry 1 does not dominate the budget next year.

Senator BUNNING. I am not asking if it dominates it.

Ms. HARRIS. Okay.

Senator BUNNING. I am just asking you the simple question of whether you are deferring or changing your maintenance schedules on other plants because of the restart of Brown's Ferry?

Ms. HARRIS. I think that what we are doing is we are maintaining our plants as they need to be maintained. We are not changing the practices of our maintenance and——

Senator BUNNING. So, you say that you are spending the extra money to restart Brown's Ferry.

Ms. HARRIS. Yes.

Senator BUNNING. As part of your overall expenditure. Nothing else is going to be changed. That is what you are saying.

Ms. HARRIS. Right. But I guess I am a little confused by isolating out an expenditure for Brown's Ferry 1 when——

Senator BUNNING. I want to know if anything else is suffering because of the restart.

Ms. HARRIS. Okay. We are not failing to invest in the infrastructure of TVA for any expenditures this year, whether it is Brown's Ferry 1 or pollution control equipment.

Senator BUNNING. Okay. If we could pass an energy bill, there would be \$2 billion extra for clean coal burning technology. So maybe you should get some of your lobbyists up here to help us pass the energy bill that we have before the Congress of the United States right now.

Ms. HARRIS. Sir, by law, we are prohibited from lobbying.

Senator BUNNING. I am kidding.

[Laughter.]

You said in 1995, your IG decided to split your auditing and your consulting.

Ms. HARRIS. That recommendation was made.

Senator BUNNING. Then why did it take 7 years for you to do it?

Ms. HARRIS. Well, I wasn't here. But if I could defer to Don, Don was here.

But, basically, what happened is, when the recommendation, my understanding is, came out, everyone said, well, this is not how they do it in the private sector. Do you want to comment on that?

Senator BUNNING. You can step right up. Don't be bashful.

Mr. HICKMAN. Senator Bunning, I am the Acting Inspector General. In 1995, my office did report that the TVA should split its nonaudit services from its financial audit services, in view of the fact that the same firm was performing those same duties.

We reported that to TVA. And management's response to us at that time was that this practice is in keeping with the normal business practices in the private sector, and at that time, they did not see it as a problem.

We contended that there was the possibility of a perception that there was an inappropriate amount of independence by the audit firm performing those same duties.

We did report that to the Congress as a part of our semiannual report.

Senator BUNNING. It just took us 7 years to get to it.

Thank you.

Thank you, Mr. Chairman.

Chairman SARBANES. Senator Enzi.

Senator ENZI. I have no further questions.

Chairman SARBANES. We did receive a letter this morning from—in fact, just a little while ago—from the OMB, who did not come in to testify, which just very briefly touches on some of these issues. Actually, they say something in that letter, though, that concerns me. I would call this to the attention of my colleagues.

“TVA is similar to the GSE’s in that both TVA and the GSE’s issue debt securities, although TVA’s are backed by the Federal Government and those of the GSE’s are not.”

I did not think that was the case. The TVA Act, I thought, said that the Federal Government does not guarantee the bonds. Don’t you put a no-guarantee language in your bonds, the TVA? Isn’t that correct? I ask our panel.

Ms. HARRIS. First of all, that would differ from everything in my understanding because since 1959, the decision was made by the Federal Government no longer to back TVA bonds and we became self-financing in 1959.

Mr. BELLER. That is our understanding from a review of the legislation.

Chairman SARBANES. I am quoting the letter that has the Director of OMB’s signature on it, Mitchell E. Daniels, Jr.: “TVA is similar to the GSE’s in that both TVA and the GSE’s issue debt securities, although TVA’s are backed by the Federal Government and those of the GSE’s are not.”

Mr. Beller.

Mr. BELLER. I do not want to speak for the TVA with respect to what its Government backing is.

I can tell you that the offering circulars that we reviewed in connection with preparing for this testimony are very explicit and it is very prominent that there is no full faith and credit backing.

Chairman SARBANES. I know that the bond-rating agencies are influenced by the fact that they think that there may be some implicit guarantee since TVA is a wholly-owned Government corporation and therefore, the Government would support them if their solvency were seriously impaired. Of course, the same argument is made to some extent about the GSE’s. But there has been a big effort to get away from the idea that there is a Government guarantee, behind these bonds. It is hard enough to sell the idea because everyone assumes there is an implicit guarantee.

Ms. HARRIS. Right.

Chairman SARBANES. But at least there is an effort to get away from that.

For the OMB then to come in here with this letter and lend considerable credence to this notion that there is a guarantee, it seems to me is completely counter to what, previously, OMB and others have been trying to do. But so much for the OMB letter, if I may say so.

[Laughter.]

I do not have any further questions.

Senator BUNNING. I believe if you have a prospectus of your bonds, that there will be a significant bold print that it is not guaranteed by the Federal Government.

Ms. HARRIS. Absolutely.

Chairman SARBANES. I see it right here on the face of it.

Senator BUNNING. That is correct.

Chairman SARBANES. Well, maybe we should send this down to OMB in response to their letter.

Senator BUNNING. We will do that.

Chairman SARBANES. We thank the witnesses very much for coming.

Senator BUNNING. Thank you very much.

Ms. HARRIS. Thank you very much.

Chairman SARBANES. And now we will go to our next panel, if they will come forward.

[Pause.]

Our second panel this morning consists of Craven Crowell, who is Chairman of GCW Consulting. Mr. Crowell served as Chairman of the Tennessee Valley Authority, subsequent of course to his nomination by the President and confirmation by the Senate, from 1993 to 2001. He is the former Chairman of the Electric Power Research Institute, has served on the Board of the Nuclear Energy Institute, and prior to becoming Chairman of the TVA, worked closely with our former colleague, Senator Jim Sasser of Tennessee.

Mr. CROWELL. Right.

Chairman SARBANES. Dr. Allan Pulsipher—have I pronounced it correctly, Doctor?

Mr. PULSIPHER. You have.

Chairman SARBANES. Executive Director and Professor of Energy Policy in the Center for Energy Studies at Louisiana State University. Dr. Pulsipher actually was a Chief Economist at the TVA in the 1980's. He has also worked with the President's Council of Economic Advisers, and has also been at the Southern Illinois University and Texas A&M.

And then the concluding panelist is Daniel Gates, the Managing Director of Moody's Investors Service. He leads there the analyst team that follows issues in the power, energy, and infrastructure sectors, and has been the global coordinator for syndicated loan ratings for Moody's.

We are very pleased to have all three of you here with us this morning. Your full statements will be included in the record. We would obviously appreciate it if you could summarize it.

Mr. Crowell, we will begin with you and then we will just move right across the panel.

STATEMENT OF CRAVEN CROWELL

CHAIRMAN, GCW CONSULTING

FORMER CHAIRMAN, TENNESSEE VALLEY AUTHORITY

Mr. CROWELL. Thank you very much, Chairman Sarbanes. And Senator Bunning, it is good to see you again, and for the Committee to invite me here.

I was going to say good morning, but I think it is already afternoon. So, I will say, good afternoon to all of you. My name is Craven Crowell and I served for 8 years—

Chairman SARBANES. That only underscores the point that we are going to include your full statements in the record.

[Laughter.]

Mr. CROWELL. Thank you. I served 8 years as Chairman of the Tennessee Valley Authority, and I had the distinct pleasure of serving at TVA for a total of 17 years, first as a member of the Senior Management Team and then, as I have said, as Chairman of the Board of Directors. I retired last year after 25 years of Federal service, and as you mentioned, Mr. Chairman, I served part of that with Senator Jim Sasser in the U.S. Senate. I now serve as Chairman of GCW Consulting, which is an energy and aviation consulting firm located in Arlington, Virginia.

TVA has played a vital role in creating prosperity for people of the Tennessee Valley since its creation in 1933. It brought opportunity and hope to thousands of people who lived mostly in rural areas and who had few prospects for enriching their lives and the lives of their children.

I can remember as a small child when TVA electricity first came to the farmhouse where my grandparents lived and the excitement electric lighting created in the rural community of Fairview, Tennessee, where they lived. There is no doubt that TVA contributed greatly to the quality of life in the Tennessee Valley and it is my fervent hope it will continue to play a vital role in creating opportunity for many generations to come. I can say with certainty, of course, that the TVA has played an important role in my life and career and I shall always be grateful for having had the opportunity to serve the people of the Tennessee Valley.

Mr. Chairman, the Committee has asked me to address two questions: whether the TVA should be required by Federal law to disclose financial and operational information to debt-holders and prospective investors, and, if so, whether the TVA should be made subject to the requirements of the Securities Act of 1933 and the Securities and Exchange Act of 1934. I want to express my appreciation to the Committee for its interests in my views on this important matter. I would, however, like to make a few preliminary comments about TVA's debt that I believe are relevant to our discussion this morning.

In 1959, Congress gave TVA the authority to issue bonds to raise capital for expansion and other related activities and subsequently set a debt limit of \$30 billion. For the next 38 years, TVA continued to increase its debt until it reached \$27.7 billion. In 1997, TVA realized that not only was the size of the debt coming dangerously close to its borrowing limit, but also the interest expense as a percent of revenue at 34 percent was having a negative impact on TVA's competitiveness.

As a result of concerns about the size of the debt, TVA developed a 10-year plan in 1997 to reduce the debt and create a stronger financial position in preparation for deregulation of the electric power industry. Since 1997, TVA has reduced its indebtedness by almost \$2.5 billion and has reduced the interest expense as a percent of revenue to 21 percent—producing a savings of nearly \$500 million per year in interest expense.

I might say, Mr. Chairman, that I am pleased that the current TVA Board of Directors has continued to focus on reducing the

debt. In all likelihood, TVA's debt is greater than the market value of its total assets in today's market, although the agency's book value remains higher than its indebtedness. It is my hope that the TVA board will continue to reduce the debt in the years ahead.

Now, if I may, let me speak to the issue you invited me here to address.

During my tenure as Chairman, TVA undertook a significant expansion of its finance program in order to lower interest costs. The collective result of those efforts over the last few years has resulted in TVA being recognized for its innovation and responsiveness to investors.

TVA entered the global bond market for the first time in 1995 and the same year issued its first bonds targeted to retail, or individual, investors. The retail bonds were enormously successful and resulted in a large increase in the number of TVA investors. With this came the recognition that TVA would need to increase the opportunities to further disclose and communicate information about the agency that was of significance and importance to the investment community.

So in 1996, TVA created a staff of investor relations professionals to ensure that investors in TVA bonds had information they needed to make informed investment decisions. The broad responsibilities of this group were to ensure the adequacy and accuracy of disclosures in TVA's annual report, quarterly reports, information statements, and periodic offering circulars.

Additionally, the investor relations department routinely handled hundreds of inquiries from investors. The TVA Board also became more active with the investment community and began hosting meetings in New York with major investors and began meeting with investors in other countries.

In every meeting I attended, the TVA was viewed as a stable, well-run Government corporation that offered a sound investment opportunity. In no instance did any investor ever express to me the slightest concern about the business standards of the TVA, the soundness of the business or the adequacy or timeliness of our disclosures.

I might add that stable rates are a very important signal to investors of TVA's business stability. But there are other significant signals as well. Investors have taken note of the outstanding operating performance of TVA's power system. Capacity and efficiency are continuing to increase and, during my tenure, TVA's nuclear program was recognized by the industry for its high level of performance.

In this discussion, we also should recognize that the TVA's operations and bond indebtedness are already subject to significant oversight to guarantee proper and complete disclosure. Two examples which have already been mentioned this morning include an independent auditor in the form of an Inspector General who will be appointed by the President with Senate confirmation, and the General Accounting Office that has full and complete access to all documents and information in TVA's possession.

TVA routinely provides information about its finances and operations in many other ways. TVA board meetings are conducted in public with opportunities for the public and news media to ask

questions on any subject; press releases are issued anytime an event occurs of interest to the citizens of the Tennessee Valley or members of the investment community; public meetings on a variety of subjects are conducted throughout the TVA area; and, perhaps of most significance, TVA's operations and activities come under the jurisdiction of Oversight Committees in both the Senate and the House.

It is my opinion, Mr. Chairman, that the TVA already exceeds the reporting requirements that would be expected of any other corporation in similar circumstances. But let us not forget a key element in this discussion. TVA is a Government corporation—100 percent owned by the U.S. Government. It exists for the sole purpose of serving the citizens of the Tennessee Valley. Its mandate is to provide services at the lowest possible cost and it does not seek to enrich shareholders or corporate executives, since it has only one shareholder—the U.S. Government. In other words, TVA is a unique and vastly different organization than you will find anywhere else in the United States.

Now, we are all aware that bonds act differently in the marketplace than equity ownership through stocks. Stock prices can change depending on the vagaries of the marketplace and, therefore, are subject to manipulation as all of us with 401(k)'s have painfully experienced in the past few months. Bonds, on the other hand, are priced at the time of issue, and, while liquidity and interest rates can contribute to some changes in value, they are a stable and predictable investment. TVA does not issue stock.

In response to the Committee's question about whether the TVA should be made subject to the requirements of the Securities Acts, I would hope the Committee would review carefully the disclosures TVA already makes before acting on legislation that, in my view, would simply add another layer of bureaucracy to TVA's operations and result in additional cost and a decrease in flexibility. In managing its debt, TVA needs the ability to move quickly and take full advantage of refinancing opportunities without being encumbered by another layer of process.

I wish to thank you, Mr. Chairman, and the other Members of the Committee for permitting me to appear here today and I would be happy to answer questions.

Chairman SARBANES. Thank you very much, sir.

We will hear from the other two panelists before we go to the questions. Dr. Pulsipher, we would be happy to hear from you.

**STATEMENT OF ALLAN G. PULSIPHER
EXECUTIVE DIRECTOR, CENTER FOR ENERGY STUDIES
MARATHON OIL COMPANY PROFESSOR OF ENERGY POLICY
LOUISIANA STATE UNIVERSITY**

Mr. PULSIPHER. Thank you, Mr. Chairman, for the invitation to testify before the Committee. I have a short statement with four main points that I will just summarize.

First, TVA is a large electric power system. It is not a regional development agency that executes Government functions. Operationally, technologically, functionally, and financially it is the same thing as the other large power systems that operate in the

Southeastern United States. And it has worked hard to transform itself into that type of an organization over the last two decades.

The exemption of TVA's securities from provisions of the Securities Act of 1933 and the Exchange Act of 1934, to the extent that it is derived from the exclusion of the registration requirements given to securities of municipal, State, and Federal Governments, has no cogent rationale with respect to TVA today.

Second, as other people have said, the accounting and investor protection issues that this Committee has spent so much time on this past year are as relevant to TVA as they are to its competitors.

To illustrate, TVA's unfinished nuclear plants are likely to go on to the accounting hall of fame's top 10 list of most write-off-resistant, unproductive assets, probably ranking just below the Empire State Building's mooring tower for dirigibles.

TVA's current outside auditor has been retained by the agency for at least over two decades, and I think it probably goes back further than that, and that firm has been the principal consultant to the agency on its accounting, informational technology and financial systems, as well as many other managerial issues. I am glad to hear that the TVA is going to change that arrangement and I think it is time that it did come to an end.

I share Senator Bunning's skepticism that anything would have been done had it not been for the concern that the Committee has expressed and acted on.

The lease/lease-back arrangements for the peaking turbines have been discussed, I think that most people would look at them as an effort to keep the financing for the turbine from showing up on TVA's books as debt and being subject to the Congressional limit. And there are other issues of this sort that you can easily find.

Third, these accounting and investor protection issues are more serious for TVA than for its competitors or other corporations because the agency lacks these even minimal mechanisms for corporate oversight, disclosure and control, whose adequacy is under consideration by the Committee. As we have heard, TVA is run by a unique but widely un-imitated, full-time, three-person board appointed by the President for 9 year terms.

Many of those who have been appointed during the past have had no experience or specialized knowledge of the electricity business before their appointment. A few board members have been very effective leaders and strategists, but these have been the exceptions.

It is useful to keep in mind that TVA "backed into" the electric power business. The three-person board arrangement was specified at its inception, well before the time that TVA transformed itself into a large regional power system.

The rationale for the initial arrangement was that TVA needed to be protected from hostile political and economic interests in the region that would be threatened by this, frankly, experimental initiative of the Federal Government. There were no arrangements in the initial organization at TVA and none have been inserted since that time to allow for regional participation or regional review or oversight of TVA's activities.

My fourth and final point is that every independent study of TVA has concluded that this three-member board is an antiquated, con-

tradictory, paternalistic arrangement that should be replaced by an independent, expanded, regionally-based, part-time board. Regardless of politics, every study has made this recommendation and, just as consistently, and also regardless of politics, every TVA board has dismissed the recommendation out of hand.

The relevance of this unique arrangement to the problems of accounting accuracy and auditing that this Committee is concerned with can be made clear by considering some of the solutions to the problems that have been identified.

For example, requiring more independence of audit committees, making audit committees responsible for the audit, and other proposals like that. Of course, in TVA's case, TVA has no external board members. It has no audit committee. Sometimes in its history, it has been lucky to have somebody on its board that had accounting experience.

The relevance of TVA's outdated double-duty board to its problems of inadequate disclosure is well illustrated by the dialogue between the Office of Management and Budget and the TVA board over the board's reticence to provide a basic business plan to explain its decision to resuscitate a nuclear unit at its Brown's Ferry site. The unit was licensed to operate in the 1970's but has been closed because of safety concerns since 1985. This effort will add eventually somewhere around \$1.7 billion to TVA's debt. The effort seems inconsistent with the movement toward the use of smaller, more decentralized generating technologies which entrepreneurs and large industrial energy users are willing to build on their tab in many other parts of the country.

While I commend OMB for asking these questions. During my experience at TVA no one, including OMB, asked these sorts of questions. Under the regulatory arrangements, TVA's competing power systems operated with, such a request would come from a public utility staff. It would be open for additional comment and analysis by other interested parties and there would be no question about the need for or desirability of responding to it.

In summary, should the Tennessee Valley Authority provide timely, accurate, and objective information about its operations, finances, and performance to its investors and customers and the public? Should the information be provided in the same format, use the same definitions, terminology, and conventions, cover the same time period, provide the same degree of detail, meet the same standards for auditing and timely disclosure, as is required of its competitors in its primary line of business? Would using SEC standards and procedures help progress toward those goals?

My answer to these questions is, of course. Why doesn't TVA do this? I have heard the answer to this question several times this morning but I am still not certain I understand it.

However, TVA and its customers and its investors have a more serious problem of corporate governance and control that is the result of an obsolete and inherently contradictory organizational structure that is long overdue for a fundamental redesign.

I want to thank you again for the opportunity to state my views and will be happy to answer any questions you may have.

Chairman SARBANES. Thank you very much, sir.

Mr. Gates.

**STATEMENT OF DANIEL GATES
MANAGING DIRECTOR
MOODY'S INVESTORS SERVICE**

Mr. GATES. Good morning, Mr. Chairman, and Senator Bunning. My name is Daniel Gates and I am a Managing Director with Moody's Investors Service. I am pleased to be here to discuss the credit ratings process, and the role of disclosure requirements in that process, particularly for the Tennessee Valley Authority. I hope that Moody's views add to the consideration of this issue, though I also appreciate that our views represent only one perspective on this matter. To begin, I will give a brief overview of what we do.

Although Moody's rates a wide range of debt obligations, the heart of our service lies in rating long-term bonds, for which we have nine primary debt rating categories. Investment-grade ratings range from a high of Aaa, down to a low of Baa. Overall, Moody's ratings are designed to provide a relative measure of risk, with the likelihood of credit loss increasing as the rating decreases. The lowest probability of default is expected at the Aaa level, with a higher expected default rate at the Aa level, and so on down through the rating scale.

It is equally important to note what our work at Moody's does not include. A rating is neither a buy nor a sell recommendation, nor is it a seal of approval; rather, our ratings reflect Moody's opinion of the relative creditworthiness of a fixed-income security. Furthermore, just as we do not insure the bonds we rate, we do not audit the financial information provided to us. Accordingly, our ratings rely heavily on the completeness and veracity of both the public financial statements and any proprietary information that may be provided to us by issuers.

In order to analyze a company's ability to meet its debt obligations, Moody's analysts rely on a variety of information sources, including publicly-available information that is filed with regulatory authorities or is otherwise available, audited financial statements, third-party analyses of the company and the industry sector, and information provided by the company directly to our analysts.

In an ideal world, the rating agencies always would have access to complete and accurate financial and operational information. We strongly believe that in the United States, the Federal securities laws add to the reliability of that information because they carry with them civil and criminal penalties for inaccurate reporting. However, outside the United States, and for some issuers like TVA, within the United States, Moody's and the other rating agencies for many years have rated companies not subject to SEC reporting requirements. For these entities, Moody's relies on the completeness and veracity of issuers' public and private disclosure of information, along with industry-specific knowledge and macro-economic analysis.

We believe that the TVA has operated in good faith in providing accurate and reliable financial information to facilitate our rating analysis, though we do prefer that all financial reporting, including by TVA, be subject to the disclosure standards set forth in the 1933 and 1934 Acts. Moody's analysts have a constructive working rela-

tionship with multiple contacts at TVA, which provides additional background on operational developments, industry news, or Government proposals. We receive annual and quarterly reports from TVA and regular briefing material.

As with any issuer, Moody's analyzes multiple factors when rating TVA. Thus, we have considered TVA's protected service territory, power costs, ability to set rates, and at the macro level, the growth rate of the region it serves. We also consider financial measures, including cash flow, balance sheet, capital structure, and prospects for raising or lowering debt in the near future. We have obtained all of this information directly from the company or from third-party sources. Finally, as a general rating approach to Government Sponsored Enterprises such as TVA, Moody's uses an integrated analysis of both the fundamental creditworthiness of the enterprise as a business, and the enterprise's relationship with the U.S. Government.

To conclude, Moody's supports steps to improve the quality and reliability of the information that market participants, including investors and our analysts, receive. This support for higher quality information, however, should not be interpreted as reflecting any particular concerns over the reliability of the financial information we have received from TVA. Rather, as a major consumer of financial data and SEC filings, Moody's supports efforts to enhance financial disclosure because these efforts improve the overall reliability of financial information in the marketplace, and thus contribute to more efficient capital markets. For that reason, we commend the SEC for setting forth disclosure alternatives and are glad to hear that TVA is willing to work with the SEC to pursue those alternatives. We look forward to the results of those discussions.

Thank you, Mr. Chairman. I would be very happy to answer any questions.

Chairman SARBANES. Thank you very much, Mr. Gates.

Mr. Crowell, I wanted to ask you, do I understand that the TVA is paying out of its power revenues for nonpower activities, and particularly for its river flood control projects? You used to get a Federal appropriation. Is that correct?

Mr. CROWELL. Correct, right.

Chairman SARBANES. Now that Federal appropriation has been done away with. Is that right?

Mr. CROWELL. That is right.

Chairman SARBANES. As a conscious decision or simply because of the workings of the budget process?

Mr. CROWELL. Really, due to the workings of the budget process. At the time, we undertook an effort to get away from using tax funds to support projects in the Tennessee Valley. It was a joint effort between the TVA Board and the Office of Management and Budget. It was a proposal to do that that was in the President's budget, the year before we did it.

Chairman SARBANES. But you are now carrying burdens that are not in any sense part and parcel of the power business. Is that right?

Mr. CROWELL. That is correct. These duties are public responsibilities—river management, economic development. Operations on

navigation flood control, which normally would be funded by taxpayers, are now being funded by the TVA out of power revenues.

Chairman SARBANES. You used to receive a Federal appropriation for that. Is that right?

Mr. CROWELL. That is correct.

Chairman SARBANES. And did you also get a Federal appropriation to do your power work, or did that all stop in 1959, when you were given the authority to issue bonds?

Mr. CROWELL. It all stopped in 1959. You are correct, Mr. Chairman. The change was made in 1959. Prior to 1959, the U.S. Treasury financed TVA's operations, the power operations. After that, TVA financed them independently.

Chairman SARBANES. Right. But the nonpower operations, the so-called stewardship activities, were still funded by the Government. Correct?

Mr. CROWELL. That is right. That is correct.

Chairman SARBANES. What is the order of magnitude of those activities, at least in recent years, if you know?

Mr. CROWELL. In recent years, I would say that the cost of doing them adequately would be somewhere around \$80 to \$90 million a year. I think the last year TVA received an appropriation, it was in the 1970's, \$70 million.

Chairman SARBANES. Now, Dr. Pulsipher, I think I may have misunderstood you. But I took something that you said to suggest that providing electricity was not part of TVA's original mandate. Is that correct?

Mr. PULSIPHER. That is right. It was set up for flood control navigation in a fairly broad, unspecified mandate. As a consequence of those activities, it started to produce power when it built dams. That grew under the leadership of David Lillienthal into the power system.

Chairman SARBANES. But I always thought it was part of the original thinking of the Tennessee Valley Authority legislation. Do you recall that?

Mr. CROWELL. I think what Allan is trying to say—and I might mention, the Committee probably does not know that Professor Pulsipher and I worked together at TVA. We reported to the same manager and I have always found him to be a very bright and thoughtful person, although I do not agree with him very often.

[Laughter.]

Chairman SARBANES. That happens around here sometimes, too.

[Laughter.]

And we make exactly the same statement.

[Laughter.]

Mr. CROWELL. But, anyway, rural electrification was part of Franklin Roosevelt's campaign I think in 1932, to not only do it for the United States, but also to do it for the area of the Tennessee Valley. So electrification was a part of TVA's mandate from the start. Allan is correct that, originally, more of the effort went into navigation, flood control of the Tennessee River because it flooded on an annual basis and caused great economic damage and loss of life. But power was always part of that. Electricity was to be sold to the people in the Tennessee Valley.

Over time, with the recognition in 1959 in the Eisenhower Administration that the electrification needed to continue, there was a major change made and TVA was then permitted to issue bonds in order to finance expansion.

Chairman SARBANES. Senator Bunning.

Senator BUNNING. Thank you very much.

Mr. Crowell, you talked about, and in your statement, you reduced it down a bit, TVA's aggressively reducing debt.

Mr. CROWELL. Yes.

Senator BUNNING. If TVA continues to pay back debt at the rate of \$50 million, which is this last year's annual debt which was repaid, it would take 250 years to do it. How does TVA plan to restructure a debt repayment plan that would eliminate its statutory debt of \$26 billion? In other words, it is supposed to be a 10-year plan that would end in 2007 to reduce it in half. I wonder how we are going to do that if we are going to do it at \$50 million a year.

Mr. CROWELL. Well, we are obviously not going to do it based on \$50 million a year.

The last budget I approved, the debt was reduced by \$600 million. Now, the 10-year plan was always viewed as something that would be revised on a yearly basis and make changes as a result of market conditions and whatever.

But the reason I made that point in the statement is that we are here discussing today before this Committee disclosure issues, when personally, I think that the more serious subject should be the size of the debt and the need to produce a plan that will reduce it in the future, because I think that, as competition occurs, the real threat to TVA's survival is going to be the size of its debt. And that is the reason I made that point. I think it is a very important issue and I know that you have—

Senator BUNNING. Well, that is my reason for examining the debt and figuring out the best way to either register it or let everybody know exactly what is going on with the debt, because it jumps out at you when you look at TVA.

Mr. CROWELL. Absolutely, it does. I would agree with you on that. I guess the point I think I am trying to make, Senator, is that I do not know that registration is going to get to the heart of the problem that you just mentioned and your concern is.

Senator BUNNING. It may not. But something has to. And so, I am having the hearing here to get ideas.

Mr. CROWELL. Of course.

Senator BUNNING. We had some on the first panel, the exchange between the SEC and Ms. Harris, that may be a way to work out something that we have not even talked about.

Mr. CROWELL. Sure.

Senator BUNNING. Mr. Gates, in your triple A rating of TVA's financial statement and corporate governance policies, do you believe that they will be able to pay back their bonds because they have the implicit backing of the Federal Government and they can unilaterally raise rates without worrying about approval of State regulators?

Mr. GATES. As discussed before, the prospectuses and other materials make clear that there is not an explicit guarantee. We also do not view there being an implicit guarantee. However, Govern-

ment ownership does have certain things that go with it, and those statutory factors together are the most essential factors in the triple A rating, and that includes the protected service territory, the ability to raise rates without regulatory review, and the Government ownership.

Senator BUNNING. So all the things I mentioned are a real basis of fact for your triple A rating.

Mr. GATES. Those are the three most important factors in the triple A rating.

Chairman SARBANES. What do you make of the OMB letter we received here this morning?

Senator BUNNING. Wait a minute. I have someone here from OMB that I am going to ask that question.

Is Jim Meatus here? Would you try to explain to us the inconsistency of Mitch Daniels' letter, where the TVA's bonds are guaranteed by the Federal Government? Or maybe I misread it or the Chairman misread it.

Chairman SARBANES. Here it is.

[Indicating.]

Senator BUNNING. I have it, too.

Chairman SARBANES. Okay.

Senator BUNNING. I did not misread it. Could you explain that to me?

Chairman SARBANES. Sir, I think it would help if you took a microphone and identified yourself for the record.

Senator BUNNING. Identify yourself.

Chairman SARBANES. We are happy to have you come forward to the table at Senator Bunning's request.

Mr. MEATUS. Thank you very much. My name is Jim Meatus. I am a Budget Examiner for TVA at the Office of Management and Budget. I am honored and pleased to be here today.

I think, if I were smart, I would go back to the office, say little today, and check with the boss to be sure, 100 percent sure, exactly what he had in mind.

Senator BUNNING. Did you see the letter?

Mr. MEATUS. Yes.

Senator BUNNING. Okay.

Mr. MEATUS. But I have an opportunity here to perhaps add some useful things for people to think about, and let me proceed.

One of the presenters here today talked about reviews that other utilities get. I am proud of the job I do at OMB, but we do have one budget examiner looking at this \$7 billion a year utility, which is point one.

Point two, Senator, you mentioned that that does jump out at you when you look at TVA. And people concerned about TVA's customers have to be concerned about TVA's debt.

Point three, and more directly in answer to your question, I participate in many discussions by thoughtful people about exactly what the triple A rating means. For years I believed, and I now think I am wrong, that the Federal Government, Senator Sarbanes, like you say, would not back up the debt. If TVA ran into problems, like any other business, TVA would pay the consequences. But about 2 years ago, I discovered that I was the only person at the staff level within OMB who believed that, because it was TVA debt,

because it was Government debt. And that is really important. That is really important to come to terms with, it seems to me, because how does a business make decisions?

In part, it makes decisions based on the integrity of the people involved, the character and so forth. And certainly, TVA is staffed with talented people with integrity. But another practical concern is the cost of capital. Frankly, I do not have the numbers in front of me. The gentleman from Moody's undoubtedly could answer the question.

Your planning horizon looks much different if you have a triple A rating than if you have something else. I think that it would be a useful exercise for people to—and perhaps the gentleman from Moody's could answer the question. If you take one of the rating agencies' rating templates and fill in the blanks for TVA and forget about the Federal Government backing up the debt, what would the debt, what rating would it be? I do not know the answer. But I know people who have told me the answer is somewhat less than a triple A. Now, I do not want to overstay my visit and I appreciate your patience. I hope my answer has made some sense to you.

Senator BUNNING. Thank you very much.

Mr. MEATUS. I will go back and check with the boss to see—

Senator BUNNING. To see what he meant? Mr. Meatus, that would really help us.

Chairman SARBANES. Mr. Gates, that is a pretty direct challenge to you.

Mr. GATES. Yes, I can respond to that.

Chairman SARBANES. Yes, I think you ought to, maybe before he leaves the table.

Mr. GATES. Well, the triple A rating is very heavily based on the statutory factors. If those statutory factors were to be changed or they were to go away, then certainly, we would review the rating for downgrade.

We do not actually have a rating template. You can look at the various financial ratios of any issuer, including the TVA, but you have to put those ratios into the context of the business risk of the enterprise. And given that TVA has the Federal ownership, the protected service territory, the ability to raise rates, and the statutory requirement that its rates be set at a level that is sufficient to cover all of its obligations and its debt, the business risk is perceived as being very small. So, therefore, the financial ratios, which do not alone look triple A, need to be viewed in the context of the current status. If that status was changed, then the triple A would go on review for downgrade.

Chairman SARBANES. I take it, Mr. Meatus, it is not one of your objectives this morning that we should walk out of here with TVA's triple A rating downgraded, is it?

Mr. MEATUS. I actually came to hear the hearing today, and I am once again pleased and honored to be here. I may get myself in trouble. I have no interest in downgrading the triple A rating if it is deserved.

Chairman SARBANES. All right. I am pleased to hear that.

Mr. MEATUS. If it is deserved.

Chairman SARBANES. Senator Bunning, I think you can go on.

Senator BUNNING. Thank you very much.

Mr. Crowell, I just want to ask one last question because it was brought out earlier in the hearing about the recommendation of splitting the auditor's job in 1996 or 1995, I forget exactly the year, by the IG. Is it true or false that because or in spite of the fact that the IG made that recommendation, that he was fired by TVA?

Mr. CROWELL. Oh, no, no.

Senator BUNNING. He was not fired by TVA?

Mr. CROWELL. No, he retired from TVA.

Senator BUNNING. He retired.

Mr. CROWELL. But this is some years later. In 1995—let me just answer your question. In 1995—

Chairman SARBANES. You were Chairman, then, right?

Mr. CROWELL. I was Chairman then.

Senator BUNNING. That is why I asked.

Mr. CROWELL. I think you make a good point because the IG would have to be commended for making that recommendation in 1995. Now the fact that he made it to the TVA board and it also went to Congress, and the fact that we missed it—if we had a crystal ball, I certainly would have separated the functions in 1995. But in 1995, that was standard operating procedure for all of corporate America and all of the Government.

Those are the kinds of issues, Senator, that you wish you could go back and do over again, but that was not the case at the time.

Senator BUNNING. They did not report to me in the House, and it was my fault because I was not on the Energy Committee over in the House.

[Laughter.]

Mr. CROWELL. No, I am simply making the point that it was standard procedure then. Nobody at that time could have predicted, in my opinion, the situation that has occurred over the past couple of years. That is a situation where, if you had a crystal ball, you could be a lot smarter.

Senator BUNNING. I appreciate all of you testifying. Thank you.

Chairman SARBANES. Senator Carper.

Senator CARPER. I have no questions, thank you.

Chairman SARBANES. Well, this has been a very helpful panel and we very much appreciate your coming and being with us today and the time and effort that was put into both the written and the oral presentations. We thank you very much.

Senator BUNNING. Thank you.

Thank you, Mr. Chairman.

Chairman SARBANES. The hearing stands adjourned.

[Whereupon, at 12:40 p.m., the hearing was adjourned.]

[Prepared statements and additional material supplied for the record follow:]

PREPARED STATEMENT OF SKILA HARRIS

DIRECTOR, TENNESSEE VALLEY AUTHORITY

SEPTEMBER 17, 2002

Good morning, Chairman Sarbanes and other distinguished Members of the Committee. My name is Skila Harris, and I serve as Director on the Board of the Tennessee Valley Authority. On behalf of TVA's Chairman Glenn McCullough and Director Bill Baxter and more than 13,000 employees, I would like to thank you for the opportunity to appear here today to give testimony on corporate responsibility at the Tennessee Valley Authority, as well as the breadth and depth of financial disclosure and oversight at TVA. I would also like to discuss what TVA will do in the future to uphold the spirit of the landmark Sarbanes-Oxley Act of 2002. We at TVA commend you, Mr. Chairman, for your leadership and perseverance on this important legislation.

TVA's Background

TVA has a proud heritage of service in the Tennessee Valley. TVA exists to serve the public good, and our leadership standard is that TVA will achieve excellence in business operations and public service for the good of the people of the Tennessee Valley region. Created by Congress in 1933, TVA serves the people of the Valley by producing reliable, affordable electric power; supporting sustainable economic development; and maintaining stewardship of the region's natural resources. A corporation of the Federal Government, TVA uses the best practices of private enterprise to achieve excellence in business operations and public service.

TVA is entirely self-financing and receives no funding from Congress. TVA's mission, set forth by the TVA Act, remains at the cornerstone of TVA's day-to-day activities in the Valley. TVA is charged primarily with providing navigation, flood control, and agricultural and industrial development, while providing electric power to the Tennessee Valley region. At the core of TVA's mission is creating value and delivering quality service for stakeholders throughout the region.

Affordable, reliable electric power is the fuel of the economy in the Tennessee Valley, and TVA's power system is setting performance records as it keeps pace with increasing power demand. TVA's electric power system has a winter dependable generating capacity of 30,365 MW and operates 59 coal-fired units at 11 plants, five nuclear reactors at three plant sites, 29 hydro power plants, and five combustion turbine plants. Through 158 local power distributors and 62 directly served industrial customers, TVA supplies electricity for 8.3 million people in the Tennessee Valley. As the Nation's largest public power system, TVA reflects the Nation's strengths and challenges in developing a strategy for providing reliable, affordable, and environmentally sound energy.

The Administration has proposed a national energy strategy that includes important efforts to restructure the electric power industry, improving the Nation's energy infrastructure and encouraging competition in the industry. TVA supports these policy reforms.

During this crucial time in our Nation's history, it is also noteworthy that TVA's mission includes a role in national defense and a long-standing history of support for U.S. national security requirements—from the early days of making munitions in Muscle Shoals, Alabama, and building dams to supply power for vital aluminum factories during World War II, to TVA's current efforts to assist the Department of Energy to obtain tritium.

In service to the region and the Nation, TVA manages the Tennessee River system, the fifth largest river system in the United States. Although similar responsibilities for resource management are funded with taxpayer dollars elsewhere in the United States, TVA uses no current appropriation dollars for this work. Fiscal year 1999 was the last year in which TVA received appropriated dollars for these activities. The 652-mile-long river, the 42,000 miles of streams and tributaries, and TVA's 49 dams and 14 navigation locks are a vital part of the Nation's navigation system, providing for the shipping of 45 million tons annually. TVA's other purposes in managing the river system include reducing flood risk and producing hydro power. The river and its 12 tributary watersheds touch 125 counties in portions of seven States.

TVA's Board of Directors is committed to achieving excellence in business operations and public service as the organization prepares for the competitive marketplace of the future. The Board and the employees of TVA are working to optimize the corporation's operational and financial performance while remaining dedicated to economic development in the Valley, environmental stewardship, integrated resource management, and stakeholder communications. While there is still much

work to be done, I am confident that a bright future lies ahead for the people we are charged to serve.

TVA's Business Practices

TVA is committed to conducting its business in an open and forthright manner that instills confidence in Congress and the Administration and in our investors, our customers, and our ratepayers within the Valley and among Federal taxpayers and citizens who have an interest in programs run by the Federal Government.

TVA's owners, investors, customers, and other stakeholders, including taxpayers, already benefit from a number of protections. I appreciate the opportunity to outline those protections and to share with you today what TVA is already doing to ensure financial integrity for our stakeholders.

For the future, TVA is also committed to doing even more, and TVA is making specific commitments to corporate responsibility, auditor independence, and increased financial disclosure that will enable us to keep the continued confidence and support of our stakeholders.

TVA's Oversight

TVA's stakeholders, including investors in its bonds, benefit from and can have confidence in the multiple levels of oversight to which the TVA is subject, as a corporation wholly-owned by the U.S. Government. Because TVA's mission as a Government-owned corporation is somewhat different from that of publicly-traded companies, the oversight under which we operate is different from that under which privately-owned, publicly-traded companies operate.

As I noted earlier, the TVA's mission is to serve the public interest by supporting economic development of the Tennessee Valley, managing a thriving Tennessee River system, and supplying low-cost, reliable power to the Tennessee Valley region. TVA's mission is quite different from the profit-oriented goals of an investor-owned company. In fact, far from calling upon the TVA to maximize earnings, TVA's Congressional charter, the TVA Act, calls for TVA to offer electricity at rates as low as are feasible—balanced with an additional requirement that TVA charge rates sufficient to meet, among other things, the annual principal and interest payments on TVA's bonds.

Privately-owned, publicly-traded companies have a similar responsibility to provide reliable goods and services to their customers while earning a fair return on investment for their shareholders. The U.S. Securities and Exchange Commission has the major regulatory and oversight role with respect to securities of publicly-traded companies; and its major focus, appropriately, is on ensuring fairness in the issuance and trading of stocks.

Another difference between TVA and publicly-traded companies is that the ownership interest in TVA is held by the Federal Government. TVA has an interest in protecting the interest of its owner, the U.S. Government and by implication the American people, although TVA does not issue stock. Consequently, TVA does not have any incentive to generate a return for shareholders, nor can TVA reward executive performance with stock options. As a result, the oversight Congress has put in place for TVA is different from the oversight for publicly-traded companies.

But make no mistake, as a Government agency, TVA is subject to considerable oversight.

TVA management is governed by a three-member Board of Directors appointed by the President and confirmed by the U.S. Senate. Board members are sworn to uphold TVA's Congressional charter, the TVA Act, which bounds the range of business activities in which TVA can engage.

TVA, like many other Government agencies, has an independent Inspector General (IG) with broad audit and investigative powers. TVA's Inspector General was previously appointed by the TVA Board of Directors but, pursuant to recent legislation, will be appointed in the future by the President. TVA's Acting Inspector General, Mr. Don Hickman, is here with me today.

TVA's Inspector General conducts audits of the TVA's financial systems, business decisions, operations, and contracts. The Inspector General is also charged with conducting investigations of possible fraud, waste, and abuse within TVA. The Inspector General routinely publicizes its hotline to employees and investigates reports of financial or accounting irregularities, in addition to its other responsibilities. The Inspector General provides semiannual reports to Congress and to the public on the results of its audit and investigative work.

In carrying out its audit responsibilities, the Office of the Inspector General provides TVA with oversight that is much like that provided by a publicly-held company's Audit Committee. The Office of the Inspector General performs many of the

same duties and functions as those of an Audit Committee but does so with more authority and professional resources. For example:

- An Audit Committee must include at least one member with financial expertise. The Inspector General's staff that oversees audits of TVA finances includes 19 certified public accountants.
- The Inspector General has greater access to TVA financial and management information than would a company's Audit Committee because the Inspector General has access to *any* information in TVA.
- The Inspector General has the authority to investigate not only financial matters but also *any* alleged ethics violation in TVA, and the Inspector General is charged by Federal statute with aggressively pursuing any such allegation.
- Also by Federal statute, the Office of Inspector General is independent of the Board of TVA. A publicly-held company's Audit Committee is a committee of the company's Board of Directors.
- The Inspector General has the authority to investigate any impropriety and report expeditiously to the Attorney General whenever the IG has reasonable grounds to believe criminal law has been violated. This authority extends not only to investigations of actions by TVA managers or employees, but also to actions by people outside TVA, such as contractors and vendors, when an alleged violation is related to TVA.

TVA also has an independent external auditor, PricewaterhouseCoopers, which is appointed by the TVA Board. The TVA's Office of the Inspector General provides oversight of the firm's work and maintains the budget for the firm's annual audit of TVA. The Inspector General also has the legal authority to determine whether TVA's audit will be performed by the Office of the Inspector General itself or by an independent external auditor.

PricewaterhouseCoopers audits TVA's financial statements in accordance with Government auditing standards and provides an opinion on whether those statements are presented in conformity with generally accepted accounting principles, or GAAP. TVA's financial results are also included in the Federal Government's consolidated financial statements, which are audited by the General Accounting Office.

In addition, Congress exercises considerable oversight over TVA, as exemplified by today's hearing. The U.S. Senate is charged with providing oversight through the Environment and Public Works Committee and its Subcommittee on Clean Air, Wetlands, and Climate Change.

The U.S. House of Representatives is charged with providing oversight through the Transportation and Infrastructure Committee and its Subcommittee on Water Resources and Environment.

The General Accounting Office (GAO) conducts frequent audits of various TVA activities and programs, often at the request of Members of Congress. GAO is also authorized by the TVA Act and the Government Corporation Control Act to audit TVA's financial statements.

Under the provision of the TVA Act, TVA is obligated to periodically provide Congress, the Federal Energy Regulatory Commission, the Office of Management and Budget, and other interested Federal and State agencies with detailed financial and operational information on the generation, transmission, and distribution of electric energy by the TVA system. The development and submission of this information is a element of the "yardstick" function that TVA was intended by Congress to serve—to better enable Congress to formulate legislative policy for the electric power industry.

TVA also files various reports with the President, Congress, and U.S. Treasury:

- Under the TVA Act, TVA files an annual report with the President and Congress, which contains financial statements and a complete report of TVA's business activities.
- Under the Government Performance and Results Act, TVA submits annual performance reports to Congress.
- Under the Government Corporation Control Act, TVA submits an annual budget to the President and TVA's proposed budget is subject to review and approval by the President and his staff in the Executive Branch as part of the normal budget preparation process.
- In accordance with OMB Circular A-34, TVA reports on a quarterly basis its financial outlays from the previous quarter to the U.S. Treasury.
- In addition, the U.S. Treasury frequently asks TVA to provide a forecast of future receipts and disbursements.

Furthermore, before TVA can issue bonds with maturities of 1 year or more, the Secretary of the Treasury must approve the time of issuance and maximum interest

rate of the bonds. Also, since most of TVA's bonds are listed on the New York Stock Exchange and trade through its bond exchange, TVA must meet the NYSE's listing requirements.

As you can see, TVA, as a Government agency, has a considerable amount of oversight that provides significant assurance to our stakeholders. Additional measures further ensure TVA's integrity in the areas of corporate responsibility, auditor independence, and increased financial disclosure.

Corporate Responsibility

By law, all TVA employees must adhere to the standards of ethical conduct for Federal employees, which require that all Officers complete ethics training and file financial disclosure statements annually. In addition to that requirement, TVA will develop a code of financial ethics consistent with the Sarbanes-Oxley Act for all Officers and Business Managers, as well as a training program on full, fair, accurate, timely, and understandable financial and nonfinancial disclosure, TVA's corporate governance practices, and financial ethics requirements for all employees who prepare TVA's financial and business reports.

Beginning with the 2002 TVA Annual Report, TVA's Board and CFO will certify the financial statements and related information for the fiscal year ending September 30, as well as all future financial statements and related information. The Information Statement, which is the TVA's primary disclosure report to the public financial markets, will be similarly certified. The certification process will include signed certifications by all TVA Officers and Business Managers of the information they provide for these reports.

Because TVA is wholly-owned by the U.S. Government and cannot issue stock, TVA Directors and Officers do not receive stock options. In addition, TVA does not presently make personal loans to its Directors or Officers and does not plan to make any such loans in the future.

Auditor Independence

TVA has significant protections in the area of auditor independence. The independent TVA Inspector General has broad audit and investigative responsibilities. The Inspector General conducts ongoing audits of TVA's operational and financial matters in accordance with Government auditing standards. The Inspector General also conducts an annual audit of the work of TVA's independent external auditor, PricewaterhouseCoopers, to ensure compliance with Government auditing standards. TVA's Office of the Inspector General itself undergoes a peer-review audit every 3 years conducted by an Inspector General from another Federal agency.

Beginning next fiscal year, the TVA will not enter into any new contracts with PricewaterhouseCoopers for nonaudit services, and the TVA will phase out all consulting and actuarial services currently performed by PricewaterhouseCoopers.

In addition, TVA's Inspector General, Senior Vice President of Procurement, and Chief Financial Officer have clearly defined the roles of all parties with responsibilities related to the external audit of TVA's financial statements in order to ensure auditor independence, with the Inspector General being responsible for the technical management of the audit contract with PricewaterhouseCoopers.

TVA is taking several other steps to ensure auditor independence, comparable to those in the Sarbanes-Oxley Act. TVA will require its external auditor to rotate the lead audit partner and the audit partner responsible for reviewing the audit every 5 years. Also, TVA's CFO, Controller, and Chief Accounting Officer will not be hired from its external auditor if they have worked on the TVA audit during the preceding year. TVA currently does not have a Chief Executive Officer, but this prohibition will also apply to TVA's CEO if TVA has one in the future.

The TVA Board will ensure an appropriate review of its external audit through quarterly meetings with the Inspector General and the external auditor.

Financial Disclosure

TVA is committed to fully disclosing all material financial and business information to the public financial markets by providing a steady flow of timely, comprehensive, and accurate information. TVA currently issues quarterly financial reports and publishes an annual report that includes a Management's Discussion and Analysis of Financial Condition and Results of Operations and audited financial statements prepared in accordance with generally accepted accounting principles.

We provide Information Statements and Offering Circulars, similar to prospectuses for publicly-traded companies, to investors and the bankers and brokers who sell TVA's bonds. TVA issues news releases on significant events and conducts open Board meetings to ensure that major decisions by TVA's Board are made in a public arena with opportunity for input from the public we serve.

TVA also conducts an annual conference in New York for financial analysts and investors and distributes a detailed Fact Book with information on TVA's strategy, finances, and operations.

TVA is forming a Disclosure Committee to document procedures for reporting material events and occurrences on a more timely basis.

Conclusion

In conclusion, TVA is committed to conducting its business in an open and forthright manner that instills confidence in Congress and the Administration and in our investors, our customers, and our ratepayers. TVA already has a number of mechanisms in place for the protection of its stakeholders, and we are committed to doing even more to ensure that we earn your continued support and confidence.

Thank you. I look forward to answering any questions the Committee might have.

PREPARED STATEMENT OF ALAN L. BELLER, ESQ.

DIRECTOR, DIVISION OF CORPORATE FINANCE
U.S. SECURITIES AND EXCHANGE COMMISSION

SEPTEMBER 17, 2002

Introduction

Chairman Sarbanes, Senator Gramm, Members of the Committee, I am pleased to have this opportunity to testify before you on behalf of the Securities and Exchange Commission regarding the application of disclosure and reporting requirements of the Federal securities laws to the Tennessee Valley Authority ("TVA"). As you know, TVA was statutorily created in 1933,¹ the same year the first of the Federal securities laws was enacted. It was formed to provide flood control, navigation and agricultural and industrial development and to promote the use of electric power in the Tennessee Valley region. From its creation in 1933, TVA has been wholly-owned by the U.S. Government and is considered an agency and instrumentality of the United States. As such, the offer and sale of its securities has been exempt from registration under the terms of the Securities Act of 1933 ("Securities Act") and its securities are exempted securities and Government securities under the terms of the Securities Exchange Act of 1934 ("Exchange Act").²

TVA's Borrowing Authority and Types of Debt Issuances

TVA is currently authorized by statute to issue only debt. Until 1959, any indebtedness incurred by TVA was backed by the full faith and credit of the United States. In 1959, Congress eliminated the backing of TVA debt by the full faith and credit of the United States. Under its current statutory authority, TVA may borrow up to \$30,000,000,000 to finance its power program and to refund any outstanding bonds and is permitted to repay the bonds only from its net power proceeds (and proceeds of any bond refunding).³ The TVA is also obligated to repay the Government for its original investment,⁴ also known as appropriation investment, which payment was \$55,000,000 in 2001. At its September 30, 2001 fiscal year end, TVA continued to have an obligation to repay the Government its remaining appropriation investment of \$508,000,000.

TVA has stated that it issues bonds in a variety of structures and sells its bonds to institutional and individual investors on a global basis. According to TVA, as of February 28, 2002, it had 49 long-term public bond issues outstanding, including at least one specifically designed for individual investors.⁵ Based on its 2001 annual report, at September 30, 2001, TVA's long-term debt was \$22,359,000,000, and its short-term debt in the form of discount notes was \$3,016,000,000. At least two of TVA's debt securities, the putable automatic rate reset securities and the Valley inflation indexed power securities, are listed and traded on the New York Stock Exchange.

¹ 16 U.S.C. § 831 *et. seq.*

² See Securities Act § 3(a)(2), 15 U.S.C. § 77c(a)(2); Exchange Act §§ 3(a)(12) and 3(a)(42), 15 U.S.C. § 78c(a)(12) and (42).

³ See 16 U.S.C. § 831n-4.

⁴ See 16 U.S.C. § 831y.

⁵ See TVA, Financing Program Highlights, undated.

Our area of interest as an agency involves disclosure to investors in TVA debt and not other aspects of Federal regulation or incentives in the power market.⁶ Because TVA is wholly-owned by the United States and does not issue any equity securities, the most appropriate way to evaluate its disclosure is from the standpoint of debt investors. In 1992, the Commission participated with the Department of Treasury and the Board of Governors of the Federal Reserve System in a Joint Report on the Government Securities Market ("1992 Report").⁷ As a Government agency, TVA was excluded from the recommendations regarding Government Sponsored Enterprises ("GSE's") in the 1992 Report. Further, the Commission has not considered the status of TVA since that time.

Application of the Federal Securities Laws

As an agency and instrumentality of the United States, the offer and sale by TVA of its debt is exempt from registration under the Securities Act, and its securities are within the definition of exempted securities and Government securities under the Exchange Act. In addition, as part of the 1959 amendments, Congress explicitly exempted the issuance and sale of TVA bonds from the requirements or limitations of any other law, which includes the Federal securities laws. Therefore, TVA does not register the offerings of its debt securities under the Securities Act, and its debt, including debt that is listed on the New York Stock Exchange, is not subject to registration under the Exchange Act. Congressional action would be required to eliminate these various statutory exemptions.

The effect of the exemptions from the Securities Act and the Exchange Act is that disclosures by TVA are largely unregulated at the Federal level. Financial statements are statutorily mandated under the Tennessee Valley Authority Act of 1933.⁸ The staff of the Commission does not review these financial statements or any other TVA disclosure documents. However, TVA is subject to general antifraud restrictions prohibiting false or misleading statements of material facts, including the omission of material facts necessary to make the statements made, in light of the circumstances under which they are made, not misleading.

TVA is also not subject to the provisions of the recently enacted Sarbanes-Oxley Act of 2002.⁹ For example, TVA will not be subject to the independent audit committee requirements, the auditor independence rules, the certification requirements or the code of ethics provisions.

Comparability of Disclosure

TVA, while a unique Federally owned corporation, has many of the same disclosure issues as publicly held utilities. TVA bonds are sold to the public in underwritten offerings. We believe investors in those debt securities are entitled to the same type of information as that provided by other issuers of public debt. We further believe that the Commission's detailed disclosure rules and filing requirements and the staff review and comment process provide the best framework for disclosing information to which investors are entitled. Currently, TVA's annual, periodic, and offering disclosures have been governed by the demands of market participants and antifraud strictures, not by our disclosure rules.

The effect of the lack of the full faith and credit backing of the United States for TVA's bonds, of course, makes TVA's disclosure more relevant. Because investors in TVA's bonds may look only to TVA's net power proceeds (and refunding proceeds) for repayment of the bonds, disclosures by TVA should give the holders of its debt a materially complete and accurate picture of the TVA's financial and operational situation to evaluate whether there may be sufficient net power proceeds to repay their bonds.

In preparation for this testimony, the staff of the Commission has considered certain recent disclosures by TVA available on their website. This overview does not represent a full review, has not involved a typical comment process with TVA, and does not attempt to cover all the comments the staff might issue in a full review. While TVA disclosures in its most recent information statement and annual report, quarterly reports, offering circulars and other materials generally include most of the same disclosures as companies that file reports with the Commission, there are

⁶TVA, as an agency and instrumentality of the United States, is not subject to the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79b(c) ("PUHCA"). Even without this exemption, we understand that TVA would not be subject to PUHCA since it is not permitted to have subsidiaries and all the utility assets and businesses therefore are held at the TVA level.

⁷Department of the Treasury, Securities and Exchange Commission, Board of Governors of the Federal Reserve System, *Joint Report on the Government Securities Market*, January 1992.

⁸See 16 U.S.C. § 831h.

⁹Pub. L. 107-204, 116 Stat. 745 (2002).

certain areas where we believe TVA's disclosures would be enhanced if the Commission's line item disclosure requirements and staff review applied.

Financial Statements. TVA provides audited annual financial statements, prepared in accordance with U.S. GAAP. TVA includes in its information statements and annual reports 3 years of Statements of Income, Cash Flows, Changes in Proprietary Capital and Comprehensive Income (Loss). TVA's presentation of the types and number of years of financial statements appear to be generally consistent with Commission rules and the financial statements that other public companies provide.¹⁰ The staff did not conduct a complete accounting review, so we are unable to state whether the financial statements meet all the line item requirements.

Management's Discussion and Analysis. It would appear that TVA provides more summary analysis and less trend information than the Commission would seek, although all of the required categories of information appear to be included.

Market Risk Disclosure. TVA provides more abbreviated disclosure regarding market risk, and in particular less quantitative disclosure, than a public reporting company would be required to provide.¹¹ TVA presents a market risk section that briefly discusses risk policies, interest rate and foreign currency risk, commodity and equity price risk and forward contracts. The discussion does not quantify the effects of price risk for commodity-based derivative instruments. In addition, there is very limited quantitative disclosure on interest-rate risk or foreign-currency risk. TVA presents no detailed quantified information surrounding its use of derivatives, other than identification of the use of interest-rate and currency swap contracts to hedge inflation-indexed and foreign currency denominated debt issues, respectively.

Business and Property. TVA's discussion of its business is somewhat less comprehensive than that which the staff would typically see in disclosure provided by publicly-owned utilities. Some of the differences in the level of disclosure provided may be attributed to the different statutory provisions applicable to the TVA and to regulated publicly-owned utilities that are subject to the strictures of the PUHCA¹² and other State and Federal laws utility, energy and environmental laws. Notwithstanding the different regulatory requirements that TVA is subject to, the staff might expect to see somewhat more disclosure in a few areas, such as types and sources of fuel and supply contracts, regulation and licensing requirements.

TVA's description of its properties is also somewhat less detailed than public reporting utilities typically provide. For example, most owners of power generation facilities include more comprehensive disclosure regarding location of, nameplate capacity in Megawatts (MW) and number of generating units in, each plant. TVA has included most of this information as it relates to its nuclear plants. However, TVA includes only aggregate summary information about its other plants.

Executive Compensation and Related Party Transactions. The staff did not find any disclosure regarding executive compensation and related party transactions. TVA is not organized in the same manner as a private corporation—for example, the directors are appointed by the President of the United States rather than elected by shareholders. TVA's information statement and annual report do not include executive compensation information that would be required by our rules. TVA's information statement and annual report also do not describe any related party relationships or transactions.¹³ As a Government entity, at least part of the information regarding compensation of directors and executive officers is likely publicly available from sources other than TVA's website.

Material Contracts. TVA does not publicly provide copies of the types of contracts that are typically filed by reporting companies.¹⁴ These might include power purchase contracts and long-term supply contracts with five key customers.

Disclosure Alternatives

There is a tension between the TVA's status as a Government agency and instrumentality and the resulting statutory exemptions on the one hand, and the need for disclosure that meets Commission standards on the other hand. As previously indicated, the 1992 Report did not address TVA because it was a Government agency and instrumentality. Unlike GSE's addressed in that report, including Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"), TVA is not a profit-making corporation with private shareholders. As such, a different statutory regime may be appropriate.

¹⁰ See generally Regulation S-X, 17 CFR 210.

¹¹ See Item 305 of Regulation S-K, 17 CFR 229.305.

¹² 15 U.S.C. § 79a.

¹³ See Items 402 and 404 of Regulation S-K, 17 CFR 229.402 and 404.

¹⁴ See Item 601 of Regulation S-K, 17 CFR 229.601.

There are a number of ways that a disclosure regime could be applied to TVA. One way would be to change the statutory scheme to eliminate the Securities Act and/or the Exchange Act exemptions. Removing the Securities Act exemption would result in registration of public offers and sales of TVA's debt and Exchange Act periodic reporting at least for so long as TVA had more than 300 holders of any class of its debt.¹⁵ Because at least two classes of TVA's debt securities are listed on a national securities exchange, without an Exchange Act exemption TVA would have to register these classes under the Exchange Act.¹⁶ Once TVA became subject to the reporting requirements of the Exchange Act, it would have to file periodic and current reports with the Commission under Exchange Act Section 13(a), including an annual report on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K.¹⁷ If TVA registered its securities and became a reporting company, its disclosures would have to comply with the Commission's detailed line item disclosure requirements.¹⁸ Given the Commission's integrated disclosure system, the information available to investors would be virtually identical even without registration under the Securities Act. In addition, TVA would become subject to the provisions of the Sarbanes-Oxley Act applicable to reporting companies. Further, TVA would have to qualify its borrowing resolution as an indenture under the Trust Indenture Act of 1939¹⁹ and would have to engage an independent trustee. Since TVA does not issue any equity, however, it is important to note that it would not become subject to the proxy or ownership reporting requirements of the Exchange Act.²⁰

Because TVA is a Government agency and instrumentality and because the Commission has not considered TVA's status since the 1992 Report (from which it was excluded), we are not advocating such a change in the statutory arrangements under which TVA operates. In particular, we believe that the Commission's objective—disclosure that meets Commission requirements and standards—can be achieved by alternative means. As one example, exemptions could be conditioned on TVA's providing the same periodic disclosure as required for reporting companies under the Exchange Act. Another possibility would be voluntary compliance or registration under the Exchange Act, a course of action recently taken by Fannie Mae and Freddie Mac and which achieves effectively the same results in respect of disclosure as eliminating the exemptions.

Conclusion

The individual and institutional investors who hold TVA's debt securities depend for repayment on TVA's net power proceeds and refundings, and not a Government guarantee. We believe that applying the Commission's disclosure requirements and processes is the preferred method of ensuring that these investors receive the materially accurate and complete disclosure they deserve. TVA's status and exemptions from the registration and reporting requirements of the Federal securities laws are not necessarily an obstacle to that result. As previously indicated, there are a number of courses of action, including voluntary action by TVA, to achieve the desired standard of disclosure that is consistent with the Commission's standards and requirements.

PREPARED STATEMENT OF CRAVEN CROWELL

CHAIRMAN, GCW CONSULTING

FORMER CHAIRMAN, TENNESSEE VALLEY AUTHORITY

SEPTEMBER 17, 2002

Good morning, Mr. Chairman. My name is Craven Crowell and I served for 8 years as Chairman of the Tennessee Valley Authority. I had the distinct pleasure of serving the TVA for a total of 17 years, first as a member of the senior management team and then, as I have said, as Chairman of the Board of Directors. I retired last year after 25 years of Federal Government service and now serve as Chairman of GCW Consulting, an energy and aviation consulting firm with offices in Arlington, Virginia.

The TVA has played a vital role in creating prosperity for people of the Tennessee Valley since its creation in 1933. It brought opportunity and hope to thousands of

¹⁵ See Securities Act § 5, 15 U.S.C. § 77e; Exchange Act § 15(d), 15 U.S.C. § 78o(d).

¹⁶ See Exchange Act § 12(a), 15 U.S.C. § 78l(a).

¹⁷ Exchange Act § 13(a), 15 U.S.C. § 78m.

¹⁸ See Regulation S-K (17 CFR 229) and Regulation S-X (17 CFR 210).

¹⁹ 15 U.S.C. § 77aaa *et. seq.*

²⁰ See 17 CFR 240.3a12-11 and Exchange Act § 16(a), 15 U.S.C. § 78p(a).

people who lived mostly in rural areas and who had few prospects for improving their lives and the lives of their children. I can remember as a small child when TVA electricity first came to the farmhouse where my grandparents lived and the excitement electric lighting created in the rural community of Fairview, Tennessee, where they lived.

There is no doubt that the TVA contributed greatly to the quality of life in the Tennessee Valley and it is my fervent hope it will continue to play a vital role in creating opportunity for many generations to come. I can say with certainty that the TVA has played an important role in my life and career and I shall always be grateful for having had the opportunity to serve the people of the Tennessee Valley.

Mr. Chairman, the Committee has asked me to address two questions: whether the TVA should be required by Federal law to disclose financial and operational information to debt-holders and prospective investors, and, if so, whether the TVA should be made subject to the requirements of the Securities Act of 1933 and the Securities and Exchange Act of 1934. I want to express my appreciation to the Committee for its interest in my views on this important matter. I would, however, like to make a few preliminary comments about TVA's debt that I believe are relevant to our discussion this morning.

In 1959, Congress gave TVA the authority to issue bonds to raise capital for expansion and other related activities and subsequently set a debt limit of \$30 billion. For the next 38 years, the TVA continued to increase its debt until it reached \$27.7 billion. In 1997, TVA realized that not only was the size of the debt coming dangerously close to its borrowing limit, but also the interest expense as a percent of revenue at 34 percent was having a negative impact on TVA's competitiveness.

As a result of concerns about the size of the debt, TVA developed a 10-year plan in 1997 to reduce the debt and create a stronger financial position in preparation for deregulation of the electric power industry. Since 1997, TVA has reduced its indebtedness by almost \$2.5 billion and has reduced the interest expense as a percent of revenue to 21 percent—producing a savings of nearly \$500 million per year in interest expense.

I am pleased the current TVA Board of Directors has continued to focus on reducing the debt. In all likelihood, TVA's debt is greater than the market value of its total assets in today's market, although the agency's book value remains higher than its indebtedness. It is my hope the TVA Board will continue to reduce the debt in the years ahead.

Now, if I may, let me speak to the issue of the disclosure of financial and operational information by the TVA.

During my tenure as Chairman, TVA undertook a significant expansion of its finance program in order to lower interest costs. The collective result of those efforts over the last few years has resulted in TVA being recognized for its innovation and responsiveness to investors.

TVA entered the global bond market for the first time in 1995 and the same year issued its first bonds targeted to retail investors. The retail bonds were enormously successful and resulted in a large increase in the number of TVA investors. With this came the recognition that TVA would need to increase the opportunities to further disclose and communicate information about the agency that was of significance and importance to the investment community.

So in 1996, TVA created a staff of investor relations professionals to ensure that investors in TVA bonds had information they needed to make informed investment decisions. The broad responsibilities of this group were to ensure the adequacy and accuracy of disclosures in TVA's annual report, quarterly reports, information statements, and periodic offering circulars.

Additionally, the investor relations department routinely handled hundreds of inquiries from investors. The TVA Board also became more active with the investment community and began hosting meetings in New York with major investors and began meeting with investors in other countries.

In every meeting I attended, TVA was viewed as a stable, well-run Government corporation that offered a sound investment opportunity. In no instance did any investor ever express to me the slightest concern about the business standards of TVA, the soundness of the business or the adequacy or timeliness of our disclosures.

I might add that stable rates are an important signal to investors of TVA's business stability. But there are other significant signals, as well. Investors have taken note of the outstanding operating performance of TVA's power system. Capacity and efficiency are continuing to increase, and, during my tenure, TVA's nuclear program was recognized by the industry for its high level of performance.

In this discussion, we also should recognize that the TVA's operations and bond indebtedness are already subject to significant oversight to guarantee proper and complete disclosure. Two examples include an independent auditor in the form of

an Inspector General who will be appointed by the President with Senate confirmation, and the General Accounting Office that has full and complete access to all documents and information in TVA's possession.

TVA routinely provides information about its finances and operations in many other ways. TVA Board meetings are conducted in public with opportunities for the public and news media to ask questions on any subject; press releases are issued anytime an event occurs of interest to the citizens of the Tennessee Valley or the members of the investment community; public meetings on a variety of subjects are conducted throughout the TVA area; and, perhaps of most significance, TVA's operations and activities come under the jurisdiction of Oversight Committees in both the Senate and House.

It is my opinion, Mr. Chairman, TVA already exceeds the reporting requirements that would be expected of any other corporation both public and private.

But, let us not forget a key element in this discussion. TVA is a Government corporation—100 percent owned by the U.S. Government. It exists for the sole purpose of serving the citizens of the Tennessee Valley. Its mandate is to provide services at the lowest possible cost and it does not seek to enrich shareholders or corporate executives, since it has only one shareholder—the U.S. Government.

We all are aware that bonds act differently in the marketplace than equity ownership through stocks. Stock prices can change depending on the vagaries of the marketplace and, therefore, are subject to manipulation as all of us with 401(k)'s have painfully experienced in the past few months. Bonds, on the other hand, are priced at the time of issue, and, while liquidity and interest rates can contribute to some changes in value, they are a stable and predictable investment. The TVA does not issue stock.

In response to the Committee's question about whether the TVA should be made subject to the requirements of the Securities Act of 1933 and the Securities and Exchange Act of 1934, I would hope the Committee would review carefully the disclosures TVA already makes before acting on legislation that, in my view, would simply add another layer of bureaucracy to TVA's operations and result in additional cost and a decrease in flexibility. In managing its debt, TVA needs the ability to move quickly and take full advantage of refinancing opportunities without being encumbered by another layer of process.

I wish to thank you, Mr. Chairman, and the other Members of the Committee for asking me to appear here today.

PREPARED STATEMENT OF ALLAN G. PULSIPHER

EXECUTIVE DIRECTOR, CENTER FOR ENERGY STUDIES
MARATHON OIL COMPANY PROFESSOR OF ENERGY POLICY
LOUISIANA STATE UNIVERSITY

SEPTEMBER 17, 2002

Thank you for the invitation to testify before this Committee. I am the Executive Director of the Center for Energy Studies at Louisiana State University. Previously I was the Chief Economist at TVA for most of the 1980's. Other relevant experience includes serving as a Program Officer with the Ford Foundation and as a Senior Staff Economist with the Council of Economic Advisers under Presidents Nixon and Ford. I have followed TVA's fortunes with interest both as an ex-employee and a student of energy policy but my attention has become more sporadic than systematic in recent years.

I have a short statement with four main points that I have outlined as follows.

First, TVA is a large electric power system not a regional development agency that executes governmental functions. Operationally, technologically, functionally, and financially it is the same as the other large power systems that operate in the Southeastern United States. The exemption of TVA's securities from provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934, to the extent that it is derived from the exemption from the registration requirements given to securities of municipal, State, and Federal Governments, has no cogent rationale today with respect to TVA.

Second, the accounting and investor protection issues that this Committee has spent so much time on this past year are as relevant to TVA as they are to its competitors. To illustrate:

a. TVA's unfinished nuclear plants are likely to go on to the accounting hall of fame's top 10 list of the most "write-off-resistant," unproductive assets, probably ranking just below the Empire State Building's mooring tower for dirigibles. To my

recollection, TVA is the only utility that still carries unfinished nuclear plants as assets on its books. Despite the fact that it has both cancelled and written off about four times as much nuclear construction as its closest competitor in the cancelled nuclear plant category.

b. TVA's current outside auditor has been retained by the agency for over two decades, and also has been the principal consultant to the agency on its accounting, informational technology and financial systems, as well as other managerial issues. I could not find the calculation or the required data in TVA's public reports, but my hunch is that TVA's payment for auditing and nonauditing services exceeds the \$2.69 in nonauditing services for every \$1 in auditing services average cited by Mr. Bevis Longstreth in testimony before this Committee on March 6, 2002.

c. TVA recently has executed lease-back arrangements for 16 peaking turbines that appear to be designed primarily to keep their financing from appearing on the agency's books as debt.

Third, these accounting and investor protection issues are more serious for the TVA than for its competitors because the agency lacks even the minimal mechanisms for oversight, disclosure and control, whose adequacy is under consideration by this Committee and many others. A unique but un-imitated, full-time, three-person board appointed by the President for 9-year terms manages TVA.

a. Many of those who have been appointed have had no experience or specialized knowledge of the electricity business before their appointment. A few board members have been effective leaders and strategists, but these have been exceptions rather than the rule.

b. It is useful to keep in mind; TVA "backed into" the electric power business. The three-person board arrangement was specified at its inception, well before that time. The rationale for the arrangement was that TVA needed to be protected from hostile political and economic interests who would be threatened by this frankly experimental initiative. There were no arrangements included in TVA's charter to allow regional participation or review of its activities.

c. Thus the oversight, regulatory, disclosure, and auditing functions that are performed by independent, external public utility commissions for the electric power systems with which TVA competes, by default, more than conscious design, are also the responsibility of TVA's three person managerial board.

Fourth, every study of TVA, the well-known study by Alex Radin former Executive Director of the American Public Power Association, the study by Regan Transition Team, the study organized by the Southern States Energy Board, have all concluded that TVA's three-member board is an antiquated, contradictory, paternalistic arrangement which should be replaced by an independent, expanded, regionally-based, part-time board. Regardless of politics, every study has made this recommendation and, just as consistently, and also regardless of politics, every TVA Board has dismissed it out of hand.

a. The relevance of this arrangement to the problems of accounting accuracy and auditing that this Committee is considering can be made clear by considering some of the solutions to those problems this Committee and others have identified. In testimony before this Committee on March 14 of this year the Director of the Brookings Institution's Economic Studies Program said: "As long as management continues to choose the auditor, the potential will always exist for a conflict that could compromise the quality of the audit." After reviewing a number of possible ways to strengthen the oversight of audits, including; requiring that only external board members serve on audit committees, charging the audit committee with the selection of the auditor, making the selection of the auditor the responsibility of a third party, prohibiting auditors from doing nonauditing work; he advised requiring the auditor to be hired by the Board's auditing committee as a pragmatic compromise.

b. In TVA's case, of course, the Board has no external members, there is no audit committee, and, in fact, it is the consequences of the Board's own managerial decisions and policies that the audit should accurately and comprehensively document and evaluate.

c. The more fundamental relevance of the TVA's outdated double-duty board to problems of inadequate disclosure is well illustrated by the dialogue between the Director of the Federal Office of Management and Budget and the TVA Board over the Board's reticence to provide a basic business plan to explain its decision to resuscitate a nuclear unit at its Brown's Ferry site. The unit was licensed to operate in the 1970's but has been closed because of safety concerns since 1985. This effort will add about \$1.7B to TVA's debt and seems inconsistent with the movement toward the use of smaller, more decentralized generating technologies which entrepreneurs and large industrial energy users are willing to build on their own tab. While I commend OMB for asking these questions, under the regulatory arrange-

ments TVA's competing power systems operate, such a request would come from a public utility staff and there would be no question about the need or desirability of responding.

d. Another example is the implicit abandonment of TVA's strategy to insure its survival and ability to compete in the future by reducing its debt and interest cost by about a half by 2007. In 1997, this strategy was spelled out and well received by both customers and investors. Since that time TVA has reduced its debt modestly but is far off the path to survival it laid out in 1997. Given this inconsistency between plan and performance, I would expect most utility analysts to predict that TVA would increase its rates to get back on the survival track it articulated in 1997. However, TVA decided to leave its rates unchanged other factors may have changed: (1) TVA may have developed a new strategy for reducing costs and revenue requirements, or (2) Revised its assessment of its competitor's positions, or (3) Decided electricity markets will remain, isolated, monopolistic and regulated. But there was no incentive, under current arrangements, to articulate and document such changes or subject them to evaluation and questioning by knowledgeable, informed, independent analysts. The same state of affairs exists about other important issues facing the agency.

In summary, should the Tennessee Valley Authority provide timely, accurate and objective information about its operations, finances and performance to its investors and customers and the public? Should the information be provided in the same format, use the same definitions, terminology and conventions, cover the same time period, provide the same degree of detail, meet the same standards for auditing and timely disclosure, as is required of its competitors in its primary line of business? Would using SEC standards and procedures help progress toward those goals?

My answer to these questions is "of course."

However, TVA, its customers and its investors have a more serious problem of corporate governance and control that is the result of an obsolete and inherently contradictory organizational structure that is long overdue for a fundamental redesign.

I want to thank you again for the opportunity to state my views and will be happy to answer any questions you may have.

PREPARED STATEMENT OF DANIEL GATES

MANAGING DIRECTOR
MOODY'S INVESTORS SERVICE

SEPTEMBER 17, 2002

Introduction

Good morning, Mr. Chairman and Members of the Committee. My name is Daniel Gates, and I am a Managing Director of Moody's Investors Service. I am pleased to be here today to discuss the credit ratings process, and the role of disclosure requirements in that process, particularly for the Tennessee Valley Authority. I hope that Moody's views add to the Committee's consideration of this issue, though I also appreciate that our opinions represent only one perspective on this matter.

Moody's Role in the Financial Markets

To understand the relationship between financial disclosure requirements and our work at Moody's, a summary of Moody's role in the financial markets may be helpful. For over 100 years, Moody's has played an important part in providing independent credit analysis and opinion to investors. Moody's assigns credit ratings to debt instruments and to other obligations to reflect the relative creditworthiness of those obligations. Moody's is the oldest credit rating agency, founded by John Moody in 1900 to rate the creditworthiness of railroad bonds. As early as 1924, Moody's was rating nearly every bond in the United States market, as well as many international bonds.

Today, Moody's is a leading global credit rating and research firm with more than 800 analysts worldwide. Our credit ratings cover a broad range of debt instruments totaling over \$30 trillion, and our analysts publish research that covers thousands of institutions. Moody's ratings are valuable informational tools used by: (1) institutional investors to analyze the credit risks associated with fixed-income securities and other obligations; (2) issuers seeking access to the capital markets; (3) regulators, for such purposes as measuring the capital adequacy of banks, broker-dealers, and insurance companies; and (4) governments, economists, the media, academics, and other market observers.

Ratings contribute to efficiencies in financial markets by providing credible and independent opinion forecasts of credit risk. The predictive quality of our credit ratings is empirically verifiable, and is evaluated by Moody's and by independent third parties. Our track record is published annually in our default studies. We make our historical ratings and default data available to subscribers, interested scholars and regulators. Although Moody's rates a wide range of debt obligations, the heart of our service lies in rating long-term bonds, for which we have nine primary debt rating categories. Investment-grade ratings range from a high of Aaa, down to a low of Baa. Ratings from Ba to C are considered noninvestment grade or speculative grade. Overall, Moody's ratings are designed to provide a relative measure of risk, with the likelihood of credit loss increasing as the rating decreases. The lowest probability of default is expected at the Aaa level, with a higher expected default rate at the Aa level, a yet higher expected default rate at the single-A level, and so on down through the rating scale.

It is equally important to note what our work at Moody's does *not* include. A rating of Aaa is neither a buy recommendation, nor is it a seal of approval; rather, the Aaa rating, like all of our ratings, reflects Moody's opinion of the relative creditworthiness of a fixed-income security. Furthermore, just as we do not insure the bonds we rate, we do not audit the financial information provided to us. Accordingly, our ratings rely very heavily on the completeness and veracity of both the public financial statements and any proprietary information that may be provided to us by issuers.

The Moody's Rating Process

Moody's takes a number of steps to ensure the rigor of our ratings process. We assign ratings by committee. Rating committees vary in size, and generally include senior and junior analysts and one or more managing directors. A Credit Policy Committee (CPC) and credit standing committees under the control of the CPC review ratings practices and policies internally.

Moody's takes active steps to maintain the integrity of our ratings process. Moody's analysts are not evaluated or compensated based upon the revenues associated with their portfolios, nor are they permitted to hold or trade the securities of the issuers they rate except in diversified funds managed by professional managers. Moody's also does not create investment products, or buy, sell, or recommend securities to users of our ratings, or invest in securities for its own account. Furthermore, although we derive 90 percent of our annual revenue from the issuers that we rate, we recognize that the long-term value of our franchise depends on our independence and objectivity, and ultimately on the predictive value of our ratings, an analysis of which we publish annually. The influence of individual issuers is further limited because Moody's does business with over four thousand issuer groups.

The Role of Disclosure Requirements for Moody's

In order to analyze a company's ability to meet its debt obligations, Moody's analysts rely on a variety of information sources, including publicly-available information that is filed with regulatory authorities or is otherwise available, audited financial statements, third-party analyses of the company and the industry sector, and information provided by the company directly to our analysts. Moody's ratings are based primarily upon the issuer's published financial reporting, and we believe that SEC's disclosure requirements are strong enough that, in the great majority of cases, we have sufficient public information to express an opinion. In addition, as a Nationally Recognized Statistical Rating Organization, companies are permitted to share material nonpublic information with Moody's. Each Moody's analyst and managing director has a portfolio of companies that he or she tracks. Moody's analysts speak periodically with issuing companies to obtain additional information, and all of these data are incorporated into the ratings process.

In an ideal world, the rating agencies always would have access to complete and accurate financial and operational information. The disclosure requirements created by the Securities Act of 1933 and the Securities and Exchange Act of 1934 ("1933 and 1934 Acts") contribute to the integrity of the financial information Moody's receives by creating civil and criminal penalties for inaccurate or incomplete reporting. As a general matter, our preference is that all financial information provided to our analysts be complete and reliable. We strongly believe that in the United States, the Federal securities laws add to the reliability of that information. Outside the United States, and for some classes of issuers within the United States, however, Moody's conducts analysis without SEC-mandated disclosure by obtaining information directly from the companies and other sources. Moody's and the other ratings agencies for many years have rated companies not subject to reporting requirements, such as foreign issuers and Government agencies, including the Ten-

nessee Valley Authority. For these entities, Moody's relies on the completeness and veracity of issuers' public and private disclosure of information, along with industry-specific knowledge and macroeconomic analysis.

While we prefer that all financial reporting be subject to the disclosure standards set forth in the 1933 and 1934 Acts, we believe that the TVA has operated in good faith in providing accurate and reliable financial information to facilitate our rating analysis of the Authority's power bonds. Moody's analysts have a constructive working relationship with multiple contacts at the TVA, and Moody's analysts regularly call on these contacts to provide, for example, additional background on operational developments, industry news, or Government proposals. We receive annual and quarterly reports from TVA and regular briefing material.

As with any issuer, Moody's analyzes multiple factors when rating the TVA. To illustrate, we have considered TVA's cash flow, balance sheet, capital structure, prospects for raising or lowering debt in the near future, protected service territory, power costs, ability to set electric rates, and at the macro level, the growth rate of the region it serves. We have obtained all of this information from the company directly or from third-party sources. Furthermore, as a general rating approach to Government Sponsored Enterprises such as TVA, Moody's uses an integrated analysis of both the fundamental creditworthiness of the enterprise as a business, and the Enterprise's relationship with the U.S. Government.

Conclusion

As I have stated, Moody's supports steps to improve the quality and reliability of the information that market participants, including investors and our analysts, receive. This support for higher quality information, however, should not be interpreted as reflecting any particular concerns over the reliability of the financial information we have received from TVA. Rather, as a major consumer of financial data and SEC filings, Moody's generally supports efforts to enhance financial disclosure, because they improve the overall reliability of financial information in the marketplace, and thus contribute to more efficient capital markets.

Original OMB Letter--Submitted Prior to The Hearing



THE DIRECTOR

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

September 16, 2002

The Honorable Paul S. Sarbanes
Chairman, Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for the opportunity to discuss the merits of additional disclosure of information regarding the finances of the Tennessee Valley Authority (TVA).

As you know, TVA is a corporation of the Federal government and therefore subject like other government agencies to the oversight and reporting requirements appropriate to Federal agencies. However, TVA also finances its operations through the issuance of debt held by the public. Therefore, it is of interest to those who purchase or trade in this debt to have access to complete and accurate information regarding TVA's financial condition and operations.

The President has said he would like TVA to be "run like a business," which should include reporting financial information commensurate with private sector disclosures. The Administration also expects energy markets to be more competitive in the future, and therefore it makes sense for all competitors in the marketplace to follow a common set of disclosure rules. Having TVA conform its disclosures to Securities and Exchange Commission (SEC) requirements could be a useful step in that direction.

It is useful to consider financial disclosures for TVA in relation to those for Government-Sponsored Enterprises (GSEs) that, unlike TVA, are privately owned. The Administration has previously stated its view that all GSEs should comply with the same corporate disclosure requirements of the Securities Exchange Act of 1934 (the "1934 Act"), as interpreted and applied by the SEC. Although TVA is a corporation of the Federal government, comparable disclosures could be of interest to the public as well as private investors in TVA's debt securities. Such disclosures could be accomplished by TVA without legislation, although under current law SEC does not have the authority to compel TVA to provide them.

TVA is similar to the GSEs in that both TVA and the GSEs issue debt securities, although TVA's are backed by the federal government and those of the GSE's are not. However, TVA does not issue equity securities that would automatically trigger SEC oversight. It also does not appear that TVA can enter the SEC's voluntary disclosure regime under the 1934 Act, which Fannie Mae and Freddie Mac recently committed to enter.

Thank you for the opportunity to share our observations.

Sincerely,

Mitchell E. Daniels, Jr.
Director

Revised OMB Letter--Submitted After The Hearing



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

THE DIRECTOR

September 16, 2002

The Honorable Paul S. Sarbanes
Chairman, Committee on Banking, Housing and Urban Affairs
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TVA is similar to the GSEs in that both TVA and the GSEs issue debt securities. TVA is different from the GSEs in that some GSEs issue equity securities but TVA does not. This may limit the SEC's legal authority to conduct oversight of TVA disclosures.

Thank you for the opportunity to share our observations.

Sincerely,

Mitchell E. Daniels, Jr.
Director